

## STUDENT ARTICLE

# REGULATORY EXPROPRIATIONS UNDER NAFTA: EMERGING PRINCIPLES & LINGERING DOUBTS

JOEL C. BEAUVAIS\*

### INTRODUCTION

In June of 2000, the Canadian firm Methanex brought a \$1 billion claim against the United States government<sup>1</sup> alleging, *inter alia*, that California's recent phase-out of the gasoline additive MTBE constitutes a compensable expropriation under the North American Free Trade Agreement (NAFTA).<sup>2</sup> NAFTA's Chapter 11 on investment establishes a number of protections for foreign investors, including Article 1110 on "Expropriation and Compensation," which requires a state party to compensate foreign investors from another party for "indirect expropriation" or "measure[s] tantamount to . . . expropriation."<sup>3</sup> The chapter goes on to establish an investor-state dispute mechanism (ISDM), whereby claims alleging violations of Article 1110 and the other investor protections may be submitted to binding arbitration.<sup>4</sup> As a result, the *Methanex* claim—probably the largest single "takings" case in U.S. history—is to be decided under international law by an *ad hoc* arbitral tribunal consisting of three private individuals

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\* J.D. Candidate, 2002, New York University School of Law. I am grateful to Professor Vicki Been for her insights regarding takings theory and for her helpful comments on an earlier draft. All remaining errors are mine alone.

<sup>1</sup> See *Methanex Corporation v. United States*, Claimant Methanex Corporation's Draft Amended Claim, (Feb. 12, 2001) [hereinafter *Methanex Draft Amended Claim*], at <http://www.methanex.com/investorcentre/MTBE.htm>. For further discussion of the *Methanex* case, see *infra* notes 138-141 and accompanying text.

<sup>2</sup> Canada-Mexico-United States: North American Free Trade Agreement, 32 I.L.M. 289 (1993), 32 I.L.M. 605 (1993) [hereinafter NAFTA].

<sup>3</sup> NAFTA, *supra* note 2, art. 1110. For an in-depth discussion of the provision, see *infra* Part I.A.

<sup>4</sup> NAFTA, *supra* note 2, arts. 115-1138. The investor-state dispute settlement mechanism is discussed at length in Part I.A *infra*.

selected by the parties to the dispute.

The *Methanex* case is one of the more recent and dramatic among nearly a dozen Article 1110 claims filed since 1997.<sup>5</sup> Corporations and creative attorneys have pressed for the interpretation of the “indirect expropriation” and “measure tantamount to expropriation” standards as requiring compensation for any “act by which governmental authority is used to deny *some* benefit of property.”<sup>6</sup> Indeed, barely two months after the *Methanex* claim was filed, a NAFTA tribunal awarded the U.S. firm Metalclad Corporation \$17 million in compensation for an expropriation claim against Mexico.<sup>7</sup> Not surprisingly, this issue has generated a storm of controversy and much ink has already been spilled analyzing Chapter 11, in general, and the Article 1110 claims, in particular.<sup>8</sup> Most of this attention has focused on the

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<sup>5</sup> Since NAFTA came into force in 1992, some sixteen publicly announced claims have been submitted to arbitration under the investment chapter, of which thirteen have involved Article 1110 expropriation claims. This number does not include cases in which investors have threatened to bring claims as a strategy to gain leverage in negotiations with governmental decision makers. The Article 1110 claims are discussed at length *infra* at Part II.

<sup>6</sup> Statement of Claim, S.D. Myers, Inc. v. Government of Canada, Oct. 30, 1998, ¶ 49 (emphasis added), at <http://www.appletonlaw.com/cases/mclaim.pdf> [hereinafter S.D. Myers Statement of Claim].

<sup>7</sup> See *Metalclad Corp. v. United Mexican States*, Case No. ARB(AF)/97/1, Award (Aug. 30, 2000), ICSID REV. – FOREIGN INV. L.J. 168, 188 (2001) [hereinafter *Metalclad Award*]. The *Metalclad* decision is discussed at length *infra* at notes 102-109 and accompanying text.

<sup>8</sup> For the most comprehensive critique of NAFTA’s Chapter 11 presently available, see Howard Mann & Konrad von Moltke, *NAFTA’s Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment*, (International Inst. for Sustainable Dev., 1999), at <http://www.iisd.org/trade/chapter11.htm>. See also Kevin Banks, *NAFTA’s Article 1110—Can Regulation Be Expropriation?*, 5 NAFTA: L. & BUS. REV. AM. 499 (1999); Samrat Ganguly, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign’s Power to Protect Public Health*, 38 COLUM. J. TRANSNAT’L L. 113 (1999); David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 ENVTL. L. REP. 10646 (2001); Howard Mann, *NAFTA and the Environment: Lessons for the Future*, 13 TUL. ENVTL. L.J. 387, 402-07 (2000); David Schneiderman, *NAFTA’s Takings Rule: American Constitutionalism Comes to Canada*, 46 U. TORONTO L.J. 499 (1996); Julie A. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55 (1999); J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999); William T. Waren, *Paying to Regulate: A Guide to Methanex v. United States and NAFTA Investor Rights*, 31 ENVTL. L. REP. 10986 (2001); Julia Ferguson, Note, *California’s MTBE Contaminated Water: An Illustration of the Need for an*

expropriation claims' potential chilling effect on governmental regulation, and the lack of transparency and legitimacy of the tribunals deciding the claims. While the majority of Article 1110 claims to date concern environmental measures, their underlying rationale is equally applicable to other spheres of government regulation, including labor and public health.<sup>9</sup> Moreover, expansion of the "indirect expropriation" standard to include regulatory takings has the potential to affect the interpretation of a host of other international investment agreements.<sup>10</sup>

A number of responses to the perceived problem have been proposed, ranging from the issuance of an interpretive statement by the NAFTA Free Trade Commission clarifying the legal standard of expropriation, to more fundamental reforms of the ISDM.<sup>11</sup> However, with a few notable exceptions,<sup>12</sup> the majority of this commentary was generated prior to the decision of any of the Article 1110 claims on the merits. Four such claims were decided in 2000, providing new insights into the likely future interpretation and significance of the provision.

This Note reevaluates current criticisms and reform proposals relating to Chapter 11, and Article 1110 in particular, in light of the emerging "jurisprudence" of the NAFTA tribunals. The Note proceeds in five parts. Part I provides an introduction to Article 1110 and the ISDM—collectively referred to as the "Chapter 11 model" of expropriation protection—with particular attention to the historical evolution of the model. Part II then explores the dominant criticisms leveled against the model. Part III provides an overview of the four Article 1110 decisions mentioned above, and Part IV identifies prominent jurisprudential trends within these decisions. Finally, Part V tenders a series of "lessons learned" regarding the likely impact of the NAFTA tribunals' emergent

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*Environmental Interpretive Note on Article 1110 of NAFTA*, 11 COLO. J. INT'L ENVTL. L. & POL'Y 499 (2000); Daniel R. Loritz, Comment, *Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed Under NAFTA's Chapter 11*, 22 LOY. L.A. INT'L & COMP. L. REV. 533 (2000).

<sup>9</sup> See Banks, *supra* note 8, at 504-06 (noting that principle underlying expropriation claims is applicable to labor and public health measures); Ganguly, *supra* note 8, at 116 (noting that "paramount interests of public health are just as threatened by possible misuse of the ISDM as those concerns raised by environmental and labor groups").

<sup>10</sup> See discussion *infra* notes 37-43 and accompanying text.

<sup>11</sup> Proposals for reform are discussed at greater length in Part V, *infra*.

<sup>12</sup> See generally Mann & Von Moltke, *supra* note 8; Gantz, *supra* note 8.

regulatory expropriation jurisprudence on environmental and social regulation, and the resulting implications for efforts to reform Chapter 11 and to influence future multilateral investment agreements.

These lessons can be summarized, by way of introduction, as follows. First, to date the NAFTA tribunals have interpreted Article 1110 relatively conservatively, placing significant limitations on the scope of government regulation subject to it. Although most recent criticism of Chapter 11 has focused on expropriation, the tribunals' decisions indicate that Articles 1102 and 1105, governing National Treatment and Minimum Standards of Treatment, respectively, may represent a considerably greater constraint on environmental and social regulation, and that these latter provisions should be the priority focus of any short-term reform efforts. Second, the awards examined cast doubt on the prospect that the remaining ambiguities in Article 1110—or the other disciplines, for that matter—can be resolved by means of isolated interpretive statements. The jurisprudential puzzles raised by Article 1110 defy precise *ex ante* resolution, as demonstrated by an examination of several proposed statements in light of the tribunals' awards. At the very least, drafters will have to approach these puzzles in a much more comprehensive fashion than has heretofore been suggested. Third, the recalcitrant ambiguity of the expropriation standard—perhaps inherent in such broad quasi-constitutional principles—highlights the primary importance of the legitimacy and accountability of the adjudicative institution. This Note concludes that, for purposes of future multilateral trade and investment agreements, replacement or radical redesign of the ISDM to provide greater accountability is essential to a proper balancing of investor protection with effective environmental and social regulation.

## I

### THE CHAPTER ELEVEN MODEL IN HISTORICAL CONTEXT

#### A. *The Model in Brief*

NAFTA's Article 1110(1) on "Expropriation and Compensation" provides, in relevant part, that:

[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or

take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except:

- (a) for a public purpose;
- (b) on a nondiscriminatory basis;

in accordance with due process of law and Article 1105(1) [providing for minimum standards of treatment, including fair and equitable treatment and full protection and security]; and on payment of compensation [as specified in the agreement].<sup>13</sup>

“Investment,” as defined in Article 1139, is an extremely broad term, extending to any “enterprise,” equity and debt securities, loans, real estate, or other property, tangible or intangible.<sup>14</sup> “Measures” include “any law, regulation, procedure, requirement or practice.”<sup>15</sup>

In addition to Article 1110, Chapter 11’s Section A includes a broad range of other “disciplines” for the protection of foreign investors. Foreign investors of one of the parties must receive treatment equal to or better than the best treatment afforded within the relevant state or province to domestic investors<sup>16</sup> or to foreign investors of non-parties.<sup>17</sup> In addition, foreign investors must be afforded the minimum standard of protection required by international law, including fair and equitable treatment and full protection and security.<sup>18</sup> Finally, foreign investors’ rights may not be conditioned on performance requirements.<sup>19</sup> The meaning of Article 1110 and the other disciplines is to be interpreted “in accordance with [the] Agreement and applicable rules of

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<sup>13</sup> NAFTA, *supra* note 2, art. 1110.

<sup>14</sup> *Id.* art. 1139.

<sup>15</sup> *Id.* art. 201. “Enterprise” is defined as “any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association.” *Id.*

<sup>16</sup> *Id.* art. 1102. For a more in-depth discussion of the requirements of this provision, see Mann & Von Moltke, *supra* note 8, at 25-32.

<sup>17</sup> NAFTA, *supra* note 2, art. 1103. For a more in-depth discussion of the requirements of this provision, see Mann & Von Moltke, *supra* note 8, at 25-32.

<sup>18</sup> NAFTA, *supra* note 2, art. 1105. For a more in-depth discussion of the requirements of this provision, see Mann & Von Moltke, *supra* note 8, at 32-34.

<sup>19</sup> NAFTA, *supra* note 2, art. 1106. For further discussion of this provision, see Mann & Von Moltke, *supra* note 8, at 34-37. In addition to the foregoing requirements, limitations are placed on the requirements that parties may place on the nationality of senior managers and members of boards of directors of enterprises, and parties are prohibited from hindering investors’ transfers relating to an investment. NAFTA, *supra* note 2, art. 1107-1108.

international law.”<sup>20</sup>

Section B of Chapter 11 establishes an ISDM whereby investors of a party may submit claims directly against another party alleging a violation of Article 1110 or the other Chapter 11 “disciplines.”<sup>21</sup> Claims meeting a number of procedural requirements<sup>22</sup> are submitted to binding arbitration under one of three mechanisms: (1) the International Center for the Settlement of Investment Disputes Convention (ICSID); (2) the ICSID Additional Facility; or (3) the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.<sup>23</sup> Claims are decided by arbitral tribunals composed of three members, one chosen by each of two parties and a third presiding member selected by agreement of the disputing parties<sup>24</sup> or, if the parties are unable to agree, by the Secretary General of ICSID.<sup>25</sup>

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<sup>20</sup> NAFTA, *supra* note 2, art. 1131. Article 1114 goes on to provide that “[n]othing in this chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure *otherwise consistent with this chapter* that it considers appropriate to ensure that investment in its territory is undertaken in a manner sensitive to environmental concerns.” *Id.* art. 1114 (emphasis added).

<sup>21</sup> See generally Gary N. Horlick & Alicia L. Marti, *NAFTA Chapter 11B: A Private Right of Action to Enforce Market Access through Investments*, 14 J. INT’L ARB. 43 (1997) (providing general analysis of Chapter 11 ISDM); Kristin L. Oelstrom, Note, *A Treaty for the Future: The Dispute Settlement Mechanisms of the NAFTA*, 25 L. & POL’Y INT’L BUS. 783 (1994).

<sup>22</sup> These requirements include the following: (1) the disputing investor must file a notice of intent to submit a claim at least 90 days prior to submission of the claim; (2) claims can be filed no earlier than six months after the events giving rise to the claim. NAFTA, *supra* note 2, art. 1119-1121. For a discussion of the practical aspects of bringing a Chapter 11 claim, see generally Clyde C. Pearce & Jack Coe, Jr., *Arbitration Under NAFTA Chapter 11: Some Pragmatic Reflections Upon the First Case Filed Against Mexico*, 23 HASTINGS INT’L & COMP. L. REV. 311 (2000).

<sup>23</sup> NAFTA, *supra* note 2, art. 1120. Arbitration under the ICSID Convention is available only if both the disputing party and the investor are parties to the Convention. Among the three parties, only the United States is presently a party to the Convention, meaning that no NAFTA claims may presently be brought under the Convention. See List of Contracting States and Other Signatories of the Convention (as of Aug. 7, 2001), at <http://www.worldbank.org/icsid/constate/c-states-en.htm>. The ICSID Additional Facility is available only if either the disputing party or the party of the investor, but not both, are parties to the ICSID Convention. Consequently, any dispute involving Mexico and Canada must, at present, be decided under the UNCITRAL Rules. For a discussion of ICSID, see Malcolm D. Rowat, *Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 HARV. INT’L L.J. 103 (1992).

<sup>24</sup> NAFTA, *supra* note 2, art. 1123.

<sup>25</sup> *Id.* art. 1124.

In order to submit a claim to arbitration an investor must consent to the jurisdiction of the tribunal and waive the right to initiate or continue claims before any administrative tribunal or court of law.<sup>26</sup> Arbitral awards may be enforced under the ICSID, the New York Convention, or the Inter-American Convention,<sup>27</sup> under which they are to be treated as equivalent to a final judgment in the court of the state party in which they are enforced.

### B. *The Historical Background*

Despite the novelty of the recent NAFTA expropriation claims, the combination of Article 1110's substantive standard with the ISDM in the model just described represents the culmination of nearly a century of international efforts in the sphere of investor protection.<sup>28</sup> Article 1110 finds its origins in the "Hull Formula"—and later the "preferred U.S. international law standard"—which held that international law entitles foreign owners of expropriated property to "prompt, adequate, and effective compensation."<sup>29</sup> Socialist and developing countries

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<sup>26</sup> *Id.* art. 1121. For an interesting discussion of the effects of this provision on the doctrines of exhaustion and *res judicata* in customary international law, see generally William S. Dodge, *National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA*, 23 HASTINGS INT'L & COMP. L. REV. 357 (2000).

<sup>27</sup> NAFTA, *supra* note 2, art. 1136(6).

<sup>28</sup> The following is a brief and superficial treatment of the subject's very rich history. For a more in-depth account, see Elihu Lauterpacht, *International Law and Private Foreign Investment*, 4 IND. J. GLOBAL LEGAL STUD. 259 (1997); Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 265-79 (1994); Kenneth J. Vandeveld, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373 (1998).

<sup>29</sup> See Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 645 (1998). Attempts to develop and enforce customary international law governing expropriation date from the late nineteenth century, and arose primarily in the context of relationships between the United States and Latin American governments. There were some agreements that addressed protection of foreign-owned property in Europe dating from the nineteenth century; however, the most intensive efforts came from the north-south relationship between capital-exporting and capital importing states. This relationship first developed between the United States and Latin America – much of Asia and Africa were still subjected to colonial rule and thus could not engage in expropriatory measures. The Hull Formula was articulated in 1938 by U.S. Secretary of State Cordell Hull in response to Mexican expropriation of U.S. agricultural and oil interests and became the cardinal principle of U.S. custom in this sphere. M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN

vigorously opposed this standard, and expropriation came to be one of the most controversial and significant issues in twentieth-century customary international law.<sup>30</sup> The North-South/East-West debate reached a climax in the mid-1970s, but was soon overtaken by rapid changes in the law and political economy of foreign direct investment.

Beginning in the 1970s, the United States followed the lead of several European countries in initiating a Bilateral Investment Treaty (BIT) program.<sup>31</sup> The major innovation of the early BITs was that they committed treaty partners to investor protections, including the preferred U.S. standard on expropriation, thus circumventing the aforementioned customary international law controversy. By 1981, the U.S. Model BIT had evolved to include

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INVESTMENTS 229-30 (1994).

Over the following half-century this standard was further developed into what has become known as the “preferred U.S. international standard,” which provides that:

- [a] state is responsible under international law for injury resulting from
- (1) a taking by the state of the property of a national of another state that
    - (a) is not for a public purpose, or
    - (b) is discriminatory, or
    - (c) is not accompanied by provision for just [meaning prompt, adequate, and effective] compensation . . .

RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §712(1) (1986).

<sup>30</sup> The Latin American response to the Hull Formula was the “Calvo Doctrine”, which held that, as a matter of international law, foreign investors had recourse to no more than the legal remedies provided by the law and forums of the host-state. Sandrino, *supra* note 28, at 267-68. During the 1960s and 1970s, the numerical dominance of the developing and socialist countries in the United Nations General Assembly permitted the approval of a series of resolutions upholding states’ rights to expropriate foreign property and requiring only “appropriate” compensation as determined by domestic law. *See General Assembly Resolution on Permanent Sovereignty Over Natural Resources*, G.A. Res. 1803, U.N. GAOR, 17th Sess., Supp. No. 17, at 15, U.N. Doc. A/5217 (1962), *reprinted in* 2 I.L.M. 223, 225 (1963) (affirming right to nationalize foreign-owned property and calling for payment of “appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty”); *Charter of Economic Rights and Duties of States*, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50-55, U.N. Doc. A/9631 (1974), *reprinted in* 14 I.L.M. 251, 264 (1975) (reaffirming standard set out in Resolution 1803).

<sup>31</sup> *See* Guzman, *supra* note 29, at 652-53; *see also* Kenneth J. Vandavelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT’L L.J. 469 (2000); Kenneth J. Vandavelde, *The Bilateral Investment Treaty Program of the United States*, 21 CORNELL INT’L L.J. 201 (1988).

the two central pillars of the NAFTA model: it deployed, for the first time, the precise language of the legal standard utilized in Article 1110,<sup>32</sup> and provided for direct enforcement of this and other protections through an ISDM.<sup>33</sup> By then, most other major capital exporting countries had adopted BIT programs as well, and by 1998 over 1,300 had been negotiated, governing investment relations between 160 different countries.<sup>34</sup> The BIT revolution has been accompanied by a major shift in capital-importing countries' policies towards foreign direct investment (FDI), a dramatic decline in expropriations,<sup>35</sup> and an explosion in capital imports to developing countries.<sup>36</sup>

### C. The Model's Progeny

The apparent success of the BIT model of investor protection has led to its deployment in several major bilateral and multilateral investment agreements. Section 1605 of the 1988 U.S.-Canada Trade Agreement utilizes the U.S. Model BIT standard for expropriation,<sup>37</sup> but significantly, the Agreement does not provide

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<sup>32</sup> "Investments shall not be *expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization* ('expropriation') except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation, and in accordance with due process of law. . ." Model Bilateral Investment Treaty (BIT) and Sample Provisions from Negotiated BIT's (Revised February 24, 1984), art. III, §1, *reprinted in* 1 BASIC DOCUMENTS OF INTERNATIONAL LAW, 655, 657 (Stephen Zamora & Ronald A. Brand, eds., 1990) (emphasis added). Similar language is used in the amended 1994 version of the treaty. 1994 Model Bilateral Investment Treaty, 1994, art. III, §1, 1997 BDIEL AD LEXIS 6.

<sup>33</sup> Investor claims were to be submitted to binding arbitration under the ICSID or UNCITRAL systems, or "any other arbitration institution . . . as may be mutually agreed between the parties to the dispute." Model Agreement, Treaty Between the United States of America and [ . . . ] Concerning the Encouragement and Reciprocal Protection of Investment, Feb. 1992, art. III(1), art. IV(3), *reprinted in* RUDOLF DOLZER & MARGARET STEVENS, BILATERAL INVESTMENT TREATIES (1995).

<sup>34</sup> Wagner, *supra* note 8, at 472. In response to this expansion, Elihu Lauterpacht comments that "[s]ince 1951 . . . international practice has evolved so considerably that the possibility of any specific [investment] dispute now falling outside the scope of one dispute settlement procedure or another is significantly reduced, though it has not disappeared completely." Lauterpacht, *supra* note 28, at 271.

<sup>35</sup> According to one commentator, between 1984 and 1992 only three direct expropriations were recorded worldwide. Guzman, *supra* note 29, at 647.

<sup>36</sup> FDI flows to developing countries soared from \$22 billion to \$244 billion between 1990 and 1996. Wagner, *supra* note 8, at 469.

<sup>37</sup> Canada-U.S.: Free Trade Agreement, Jan. 2, 1988, § 1605, 27 I.L.M. 281,

for *mandatory* direct investor dispute settlement. Instead, disputes are referred to an intergovernmental commission, which has discretion to decline to refer them to binding arbitration.<sup>38</sup> Ratified in 1992, NAFTA was thus the first multilateral treaty to combine the “indirect or direct expropriation” standard with mandatory direct investor-dispute settlement by binding arbitration. The 1994 European Energy Charter follows this model, adopting a version of the preferred U.S. international standard on expropriation,<sup>39</sup> and providing for mandatory direct investor-state dispute settlement.<sup>40</sup> The 1996 Canada-Chile Free Trade Agreement’s provisions on expropriation and investor-state dispute settlement are virtually identical to those of NAFTA.<sup>41</sup>

Not surprisingly, the incorporation of the NAFTA expropriation language (verbatim) and ISDM into the Organisation for Economic Co-Operation and Development’s (OECD) negotiating text of the Multilateral Agreement on Investment (MAI) received considerable attention.<sup>42</sup> Adoption of the MAI

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375 (1988) [hereinafter CFTA]. See generally Jean Raby, *The Investment Provisions of the Canada-United States Free Trade Agreement: A Canadian Perspective*, 84 AM. J. INT’L L. 394 (1990).

<sup>38</sup> CFTA, *supra* note 37, arts. 1801-06.

<sup>39</sup> Article 13 provides for compensation for investments “nationalized, expropriated or subjected to a measure or measures having effect equivalent to nationalization or expropriation”. Energy Charter Treaty, Dec. 17, 1994, art. 13(1), 34 I.L.M. 360, 391 (1995) [hereinafter European Energy Charter]. Interestingly, the United States declined to become a signatory to the Charter, citing the fact that “some important negotiating parties were not able to agree on a text that would have met the international investment standards that the United States has obtained in its bilateral investment instruments and in multilateral investment agreements.” Shaun Donnelly, U.S. Government Statement, European Energy Charter Treaty Meeting (Dec. 15-16, 1994) in 34 I.L.M. 556, 557-58.

<sup>40</sup> Disputes are to be settled by binding arbitration under the rules of the ICSID, ICSID Additional Facility, UNCITRAL, or the Arbitration Institute of the Stockholm Chamber of Commerce. European Energy Charter, *supra* note 39, art. 26(4).

<sup>41</sup> Canada-Chile: Free Trade Agreement, November 18, 1996, art. G-10, 36 I.L.M. 1067, 1116, 1118-22 (1996). See also Thomas Andrew O’Keefe, *The Evolution of Chilean Trade Policy in the Americas: From Lone Ranger to Team Player*, 5 SW. J.L. & TRADE AM. 251, 258-61 (1998) (discussing Canada-Chile Free Trade Agreement).

<sup>42</sup> MAI Negotiating Text (as of Apr. 24, 1998), art. IV(2), available at <http://www.oecd.org/daf/investment/fdi/mai/maitemtext.pdf>. For commentary on the MAI, see Robert Strumberg, *Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 CORNELL INT’L L.J. 491 (1998); Mark Valliantos, *De-Fanging the MAI*, 31 CORNELL INT’L L.J. 713 (1998); Wagner, *supra* note 8,

would have globalized the NAFTA model, extending its reach to investment disputes among the OECD's twenty-nine member states and perhaps beyond. However, the MAI negotiations were abandoned in 1998, due, in part, to growing environmentalist concern regarding expropriation claims under NAFTA. It is not known whether and in what form the MAI will be resuscitated. In the meantime, there is reason to believe that some form of the NAFTA model will be incorporated into the Free Trade Agreement for the Americas, currently under negotiation and slated for completion by 2005, which would expand the scope of the model's application to investment relations among thirty-four countries in the Western Hemisphere.<sup>43</sup>

## II

### CRITIQUING ARTICLE 1110 & THE ISDM

If the various elements of the Chapter 11 model are not novel, their combination and application under NAFTA in recent years certainly is. Since NAFTA came into force in 1992, some sixteen publicly-announced claims have been submitted under the investment chapter, of which nine have involved Article 1110 expropriation claims.<sup>44</sup> The storm of criticism generated by the Article 1110 claims can be synthesized as follows: (1) Article 1110

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at 480-86.

<sup>43</sup> See Antonio R. Parra, *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment*, 12 ICSID REV. – FOREIGN INV. L.J. 287, 364; see also Draft Agreement, Free Trade Area of the Americas, Chapter on Investment (July 3, 2001), art. 10, 15, [http://www.ftaa-alca.org/ftaadraft/eng/ngin\\_e.doc](http://www.ftaa-alca.org/ftaadraft/eng/ngin_e.doc) (incorporating proposals identical to or substantially similar to NAFTA Art. 1110 and NAFTA investor-state dispute mechanism).

<sup>44</sup> This number does not include cases in which investors have threatened to bring claims as a strategy to gain leverage in negotiations with governmental decision makers. See, e.g., the Canadian tobacco labeling case discussed *infra* at notes 83-84 and accompanying text. Nor does it include cases in which a party had filed a notice of intent to submit a claim to arbitration, but no notice of arbitration had yet been submitted at the time of publication. Documents and information relating to the Chapter 11 claims are available on a number of websites, the most comprehensive of which is NAFTALAW.ORG at <http://www.cyberus.ca/~tweiler/naftaclaims.html>. Other helpful websites include those maintained by trade lawyer Barry Appleton at <http://www.appletonlaw.com> (last visited Mar. 12, 2002), the Canadian Department of Foreign Affairs and International Trade at <http://www.dfait-maeci.gc.ca/tna-nac/menu-e.asp> (last visited Mar. 24, 2002), and the U.S. Department of State at <http://www.state.gov/s/l/c3439.htm> (last visited Mar. 12, 2002).

and Chapter 11's other disciplines are conducive to expansive interpretation in favor of foreign investors, but are unbalanced by any countervailing protections for environmental and social interests; (2) the arbitral tribunals charged with interpreting Chapter 11's substantive provisions are unaccountable, non-transparent, and lack procedural safeguards; and (3) critics charge that the early NAFTA expropriation claims are the harbingers of a regime under which Chapter 11 tribunals substantially undermine state capacity to regulate. This Part unpacks this critique, examining each of its three elements—the legal standard, the dispute settlement mechanism, and the expected results—in the interest of providing a standard against which the Chapter 11 tribunals' early awards may be measured.

#### A. *Evaluating the Expropriation Standard*

From the viewpoint of investors and capital-exporting states, the virtues of including substantive protections against expropriation in international investment agreements are manifest. Few countries—including other developed countries—provide the level of legal protection to private property afforded by the United States,<sup>45</sup> and in many areas of the world there has been a long history of expropriating foreign property. Consequently, investors—particularly U.S. investors—are eager to secure for themselves enforceable legal protections against the potential vagaries of foreign government regulation.

The primary justifications for an international legal standard requiring compensation for expropriations—regulatory or otherwise—are three. First, such protections are argued to force governments to internalize the costs of regulation and, thus, to deter inefficient over-regulation.<sup>46</sup> Such cost-internalization mechanisms may be even more necessary in the international context because foreign investors may not participate in the

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<sup>45</sup> Canadian law, for example, requires compensation only where the benefit of the property taken is transferred to the government. See Wagner, *supra* note 8, at 510-13. But see Gaetan Verhoosel, *Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking a "Reasonable" Balance Between Stability and Change*, 29 LAW & POL'Y INT'L BUS. 451, 471-72 (1998) (discussing potential exception to general transfer of property rights requirement).

<sup>46</sup> See Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 HARV. L. REV. 997, 998-1002 (discussing purposes of takings clause).

domestic political system, thus reducing the political “costs” of taking foreign-owned property in comparison with takings of domestic property.<sup>47</sup> Second, it may be considered unfair that the firm whose property is taken should bear the entire cost of the social benefit realized through the taking;<sup>48</sup> this problem is particularly salient in the case of foreign investors who may be more subject to discriminatory treatment than domestic firms.<sup>49</sup> Here, the compensation requirement serves to distribute the cost of social regulation among the beneficiaries, or society at large, by means of taxation and payment of compensation to the “victim.” Third, and perhaps most importantly in the NAFTA context, the compensation requirement encourages FDI by providing foreign investors with a type of *ex post* “insurance” against potential expropriatory losses.<sup>50</sup>

The merits of each of these justifications is contestable,<sup>51</sup> but the primary criticism of the Chapter 11 model is not that a substantive expropriation protection is generally unwarranted, but rather that the particular standard provided by Article 1110 is vague and overbroad. Although the provision’s language has a pedigree dating from at least 1981,<sup>52</sup> none of the core terms, including “direct expropriation,” “indirect expropriation,” or “measures tantamount to expropriation,” is defined in NAFTA or its predecessor agreements.<sup>53</sup> NAFTA’s Article 102 provides that

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<sup>47</sup> *But see infra* note 51.

<sup>48</sup> *See, e.g.* *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 123 (1978) (“The Fifth Amendment’s guarantee . . . [is] designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.”) (quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960)).

<sup>49</sup> *See* Saul Levmore, *Just Compensation and Just Politics*, 22 *CONN. L. REV.* 285, 309-11 (1990) (arguing that compensation requirements are especially justified where majorities may mistreat minorities); William Michael Treanor, *The Original Understanding of the Takings Clause and the Political Process*, 95 *COLUM. L. REV.* 782, 855-887 (1995) (arguing that compensation should be mandatory only for cases of expropriation resulting from a “political process failure”—that is, where expropriations are directed against a particular group marginalized from participation).

<sup>50</sup> *See, e.g.* Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72 *CAL. L. REV.* 569, 582-99 (1984).

<sup>51</sup> *See* Vicki Been, *The Global Fifth Amendment: NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine* 36-56 (Oct. 2001) (unpublished manuscript on file with author).

<sup>52</sup> *See supra* note 32.

<sup>53</sup> As early as 1986, Rudolf Dolzer analyzed language concerning indirect

the agreement is to be interpreted “in light of its objectives” and “in accordance with applicable rules of international law.”<sup>54</sup> Unfortunately, neither the agreement’s stated purposes nor rules of international law provide any clear guidance.

The explicit objectives stated in Article 102 include, *inter alia*, “promot[ing] conditions of fair competition” and “increas[ing] substantially investment opportunities.”<sup>55</sup> These objectives might be interpreted to suggest a bias in favor of aggressive protection of investors.<sup>56</sup> However, the agreement’s preamble includes a resolution to undertake the promotion of free trade and investment “in a manner consistent with environmental protection and conservation.”<sup>57</sup> Moreover, NAFTA’s “side agreements,” the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC), discourage the parties from weakening environmental or labor standards in the interest of attracting foreign investment.<sup>58</sup>

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expropriation in bilateral investment treaties that was nearly identical to that of Article 1110. He noted that “the current versions of investment treaties do not in any way illuminate the issue of indirect expropriations; they rather state the problem, and presumably the rules of general international law are meant to provide solutions.” Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV. – FOREIGN INV. L.J. 41, 56 (1986).

<sup>54</sup> NAFTA *supra* note 2, art. 102. As several NAFTA tribunals have pointed out, the Vienna Convention on the Law of Treaties provides that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of treaty in their context and in light of its object and purpose.” Vienna Convention on the Law of Treaties, art. 31, U.N. Doc. A/CONF.39/27 (May 23, 1969), *reprinted in* INTERNATIONAL LAW: SELECTED DOCUMENTS, 1999-2000 Ed. 49, 58-59 (Barry E. Carter & Phillip R. Trimble eds., 2000). The context and purpose include the treaty’s full text, including the preamble and annexes, as well as any agreement or instrument made by the parties in relation to the treaty. *See id.* “Supplementary means of interpretation,” such as preparatory work for the negotiation of the treaty, may be used only where the foregoing means leave the treaty’s meaning obscure or lead to an absurd interpretation. *Id.* art. 32.

<sup>55</sup> NAFTA, *supra* note 2, art. 102.

<sup>56</sup> Indeed, one tribunal based its decision in part on just such an interpretation. *See Metalclad Award*, *supra* note 7, at ¶ 70, (quoting language from NAFTA preamble as relevant to applicable law). The case is discussed at greater length *infra* Part II.A.

<sup>57</sup> NAFTA, *supra* note 2. The Preamble goes on to call for the preservation of governmental “flexibility to safeguard the public welfare,” the strengthening of “the development and enforcement of environmental laws and regulations,” and the “enhance[ment] and enforce[ment of] basic workers’ rights.” *Id.*

<sup>58</sup> *See* North American Agreement on Environmental Cooperation, Sept. 14,

The applicable rules of international law on the subject of expropriation are at least as ambiguous as the treaty's objectives.<sup>59</sup> There is good reason to believe that Article 1110's language was intended to refer to as "constructive takings" or "creeping expropriation."<sup>60</sup> "Constructive takings" refers to the notion that governments may effectively deprive foreign investors of the use and enjoyment of their property without physical occupation or transfer of title.<sup>61</sup> "Creeping expropriation" refers to a subset of constructive takings in which a government deprives a foreign investor of property by means of cumulative imposition of regulatory measures, any one of which might be permissible, but whose sum leads to compensable expropriation.<sup>62</sup>

Despite the scholarly attention devoted to the foregoing since as early as 1959,<sup>63</sup> legal standards have remained vague at best. In

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1993, art. 3, 32 I.L.M. 1480, 1483 ("[E]ach Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations."); North American Agreement on Labor Cooperation, Sept. 14, 1993, art. 2, 32 I.L.M. 1499, 1503 ("[E]ach Party shall ensure that its labor laws and regulations provide for high labor standards, consistent with high quality and productivity workplaces, and shall continue to strive to improve those standards in that light.").

<sup>59</sup> In the oft-cited words of the United States Supreme Court in *Banco Nacional de Cuba v. Sabbatino*, "[t]here are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens." 376 U.S. 398, 428 (1964).

<sup>60</sup> This inference is based primarily on the RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §712 cmt. g (1986). The comment notes that the section's proscription of takings "applies not only to avowed expropriations in which the government formally takes title to property, but also to other actions of the government that have the effect of 'taking' the property, in whole or in large part, outright or in stages ('creeping expropriation')." *Id.* For a classic discussion of constructive takings, see generally Burns H. Weston, "Constructive Takings" Under International Law: A Modest Foray into the Problem of "Creeping Expropriation," 16 VA. J. INT'L L. 103 (1975). Weston appears to equate the terms "indirect," "de facto," "disguised," "constructive," and "creeping" expropriation. *See id.* at 105-06.

<sup>61</sup> *See* Weston, *supra* note 60, at 118-19.

<sup>62</sup> *See id.* at 109.

<sup>63</sup> *See* Richard N. Gardner, *International Measures for the Promotion and Protection of Foreign Investment*, 1959 PROC. AM. SOC'Y INT'L L. 255, 262. *See also* G.C. Christie, *What Constitutes a Taking of Property Under International Law?*, 38 BRIT. Y.B. INT'L L. 307 (1962); Martin Domke, *Foreign Nationalizations: Some Aspects of Contemporary International Law*, 55 AM. J. INT'L L. 585, 589 (1961) ("An outright transfer of title may no longer constitute the foremost type of 'taking' property in the technique of modern nationalization. There are various other means of 'creeping' or 'disguised' nationalization through regulations of foreign governments."); Weston, *supra* note 60.

the words of one noted authority, “[t]here is little guidance to be had from the existing authorities on the making of the distinction between compensable takings and regulatory non-compensable takings.”<sup>64</sup> Moreover, the identification of the phenomenon of “indirect expropriation” does not help to establish clear legal standards for its application.<sup>65</sup> International “judicial” precedent offers little help. Until relatively recently, most international law on expropriation dealt with direct nationalization of foreign property the status of which as “takings” was not at issue. Few cases reporting “constructive takings” are available,<sup>66</sup> and there are noteworthy differences in the legal standards under which existing decision have been articulated.<sup>67</sup> Finally, as is the case in domestic takings jurisprudence in the United States, factual differences among cases and scenarios can play a very significant role in shaping legal standards.<sup>68</sup>

<sup>64</sup> SORNARAJAH, *supra* note 29, at 300-01.

<sup>65</sup> *See id.* at 282 (“Such descriptions, while providing a label for takings outside the obvious situation of direct takings of physical property, do little to further the identification of indirect takings which will attract the application of international law on nationalisation.”). Rudolf Dolzer concurred: “[O]ne cannot but admit at this stage that the law of indirect expropriation can be established, at this moment, on the basis of primary sources of international law, only in a very sketchy and rough manner.” Dolzer, *supra* note 53, at 59.

<sup>66</sup> *See* Weston, *supra* note 60, at 107.

<sup>67</sup> For instance, the Iran-U.S. Claims Tribunal (IUCT), which represents the single largest source of international expropriation decisions, has jurisdiction over “all measures affecting property rights,” a standard significantly broader than “expropriation” per se. *See* SORNARAJAH, *supra* note 29, at 282-83 (noting that “such a wide definition of taking will not be acceptable in international law.”).

<sup>68</sup> In the words of one commentator,

[E]ven slight variations in the facts can produce substantial differences in results. There are some guiding principles in deciding what kind of interference will constitute a taking, but they apply only to a certain degree. To push them further may lead to unsound conclusions. Thus, outside of the fairly clear cases . . . one must proceed with caution.

Christie, *supra* note 63, at 336; *see also* Weston, *supra* note 60, at 106 (“[J]udgments of this kind commonly depend on highly subjective responses to fact patterns discerned.”).

Similar observations have been made regarding U.S. Fifth Amendment takings jurisprudence, particularly in the regulatory sphere. *See, e.g.*, Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978) (“[W]hether a particular restriction will be rendered invalid by the government’s failure to pay for any losses proximately caused by it depends largely ‘upon the particular circumstances [in that] case.’”) (citation omitted); *see also* Susan Rose-Ackerman & Jim Rossi, *Disentangling Deregulatory Takings*, 86 VA. L. REV. 1435, 1444-50 (2000) (criticizing ad hoc nature of U.S. takings jurisprudence).

B. *The Investor-State Dispute Mechanism: Two Sides of a Coin*

The ISDM, for its part, has two critical effects on the enforcement of NAFTA's substantive investor protections. First, it provides private investors with standing under international law,<sup>69</sup> giving them a direct role in the enforcement of legal protections and releasing them from their traditional dependence on their home country government to seek redress on their behalf.<sup>70</sup> This is said to diminish the effect of interstate power politics on investor rights and to compensate for governments' inability adequately to represent all claims.<sup>71</sup>

Second, investors are provided with a means of seeking legal redress without recourse to the domestic courts of the host country, conferring considerable advantages on foreign investors. These investors reportedly perceive arbitral tribunals as circumventing bias against them in domestic courts,<sup>72</sup> and the arbitrators' presumed expertise in the subject matter of investment disputes is believed to insure against the pitfalls associated with jury trials.<sup>73</sup> Arbitration is considerably more flexible, confidential, and economical than domestic litigation,<sup>74</sup> but, in contrast to other alternative dispute resolution mechanisms such as negotiation or

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<sup>69</sup> This is analogous to the grant of a statutory cause of action in the U.S. domestic context. See, e.g., WILLIAM N. ESKRIDGE, JR. & PHILIP P. FRICKEY, *CASES AND MATERIALS ON LEGISLATION* 891 (2d ed. 1995) ("[M]any statutes explicitly provide for enforcement by private lawsuits, unmediated by public enforcers.").

<sup>70</sup> For a discussion of the traditional limitation of international legal personality and standing to states, see, for example, LOUIS HENKIN ET AL., *INTERNATIONAL LAW: CASES AND MATERIALS* 677-78 (3d ed. 1993).

<sup>71</sup> See Justin Byrne, Comment, *NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access*, 35 *TEX. INT'L L.J.* 415, 428-29 (2000).

<sup>72</sup> See, e.g., Hope H. Camp, Jr., *Dispute Resolution and U.S.-Mexico Business Transactions*, 5 *U.S.-MEX. L.J.* 85, 89, 91 (1997); see also Parra, *supra* note 43, at 289 (noting reluctance of foreign investors and host states to submit to jurisdiction of courts of adverse party). In addition, the claimant's right to appoint one of the three arbitrators helps to provide greater confidence that its claim will be given serious consideration. See Andreas F. Lowenfeld, *The Party-Appointed Arbitrator in International Controversies: Some Reflections*, 30 *TEX. INT'L L.J.* 59, 65 (1995) (discussing party-appointed arbitrator's role in giving confidence to party-disputant that claim will be given fair hearing); Alan Scott Rau, *Integrity in Private Judging*, 38 *S. TEX. L. REV.* 485, 527 (1997) (noting "widely-shared conviction that the ability to participate in the selection of arbitrators is critical to fairness in dispute resolution.").

<sup>73</sup> See Camp, *supra* note 72, at 90, 92; Parra, *supra* note 43, at 289.

<sup>74</sup> See Camp, *supra* note 72, at 91-92.

conciliation, arbitration results in a binding award that is consistently enforceable and difficult to overturn.<sup>75</sup>

Despite these procedural advantages, critics argue that the tribunals charged with Chapter 11's interpretation lack the necessary institutional legitimacy and procedural safeguards: Chapter 11's model of adjudication may be appropriate for purely commercial dispute resolution—where the parties have agreed to a “streamlined” procedure in the interest of flexibility and economy—but not for cases, such as these, which involve major public policy issues.<sup>76</sup>

Under the ISDM, disputes are not heard by a standing body of independent, professional judges, but rather by mixed panels of arbitrators. The parties appoint these arbitrators and the arbitrators' votes are not made public.<sup>77</sup> As a result, the traits of independence and accountability, upon which judicial legitimacy

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<sup>75</sup> See *id.* at 90-91. Arbitral awards may, on rare occasions, be overturned by domestic courts or by annulment under Article 52 of the ICSID Convention. Rowat, *supra* note 23, at 112-18. Grounds for annulment include the following: (a) the tribunal was not properly constituted; (b) the tribunal has manifestly exceeded its powers; (c) there was corruption by members of the tribunal; (d) there was a serious departure from a fundamental rule of procedure; or (e) the award failed to state the reasons on which it is based. ICSID Convention, art. 52(1). *Id.*

The Metalclad decision, discussed below at *infra* Part III.B was partially overturned upon review by the Canadian court in which the award was to be enforced. See *United Mexican States v. Metalclad Corp.*, 89 B.C.L.R. (3d) 359 (Sup. Ct. B.C. 2001), available at <http://www.courts.gov.bc.ca/jdb-txt/SC/01/06/2001BCSC0664.htm>. The scope of such domestic court review is determined by the relevant national legislation providing for enforcement of arbitral awards. Generally, such review is limited to jurisdictional issues, but as the Supreme Court of British Columbia's decision demonstrates, the boundary between jurisdiction and the merits is often blurred. See *id.*

Canada's Attorney General has also sought review in Canadian federal court of the S.D. Myers decision. See Notice of Application, In the Matter of an Arbitration Under Chapter 11 of the North American Free Trade Agreement (NAFTA) Between S.D. Myers, Inc., and the Government of Canada (Feb. 8, 2001), at <http://www.dfait-maeci.gc.ca/tna-nac/SDMyersTrialDivision.pdf>.

<sup>76</sup> See Mann & Von Moltke, *supra* note 8, at 6.

<sup>77</sup> The widely recognized trait of “partisanship” among party-appointed arbitrators may be appropriate for private disputes in which the parties have agreed to this mode of dispute resolution, but seems unacceptable in the context of matters with such a weighty influence on critical areas of public policy. See Rau, *supra* note 72, at 506-08 (“In most cases, then, the partisan nature of a party-appointed arbitrator will be well understood, and the expectations of the parties clear enough. This is not, however, necessarily true in the conduct of international arbitrations.”).

are traditionally based, are hindered if not absent. Moreover, precedent does not bind the tribunals and there is no general mechanism for appeal. Thus, any judgment might depart from previous interpretations of the agreement and of international law, exacerbating the uncertainty associated with NAFTA's already vague substantive standards. The standard for annulment of a decision either under ICSID or domestic legislation places most decisions well beyond review,<sup>78</sup> meaning that there is little prospect of reviewing arbitrary, erroneous, or inconsistent decisions.

In addition, the rules of evidence are flexible, the discovery process is minimal in comparison with domestic courts, and the panels' work is largely insulated from public scrutiny or public participation.<sup>79</sup> Finally, although the two NAFTA states not party to a dispute are permitted to submit their views to a tribunal under Article 1128,<sup>80</sup> there is no possibility for direct intervention of other interested parties or even any guarantee that *amicus* submissions of such parties will be accepted.<sup>81</sup>

### C. Potential Costs to Environmental & Social Policy

Chapter 11's critics fear that unaccountable and nontransparent ad hoc tribunals will interpret Article 1110 and other indeterminate investor protections broadly, subverting governmental capacity to regulate in the public interest. The potential for significant arbitral awards against state parties to

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<sup>78</sup> See *supra* note 75.

<sup>79</sup> The NAFTA Free Trade Commission recently issued an interpretive statement clarifying that "[n]othing in the NAFTA imposes a general duty of confidentiality" and that, subject to the limitations imposed by the relevant arbitral rules, documents associated with NAFTA arbitrations may be released (once certain confidential information has been redacted). See Notes of Interpretation to Certain Chapter 11 Provisions (NAFTA Free Trade Commission, July 31, 2001), <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp>. However, as one commentator has pointed out, this may simply provide an incentive for parties to utilize the UNCITRAL rather than the ICSID Additional Facility rules, because the former do provide for confidentiality of party submissions. Todd Weiler, Trade Ministers Say the Darndest Things (Aug. 2001), at <http://www.naftalaw.org/Newsletter%20Commentary.pdf>.

<sup>80</sup> NAFTA, *supra* note 2, art. 1128, at 645.

<sup>81</sup> The *Methanex* tribunal has recently ruled that it will accept *amicus* submissions, but this is, of course, entirely at the tribunal's discretion. See Decision of the Tribunal on Petitions from Third Persons to Intervene as "Amici Curiae," *Methanex Corp. and United States of America* (Jan. 15, 2001), <http://www.naftalaw.org/methanex/Methanex%20-%20Amicus%20Decision.pdf>.

NAFTA may make environmental and social legislation more costly, thus chilling the regulatory impetus.<sup>82</sup> Savvy investors are empowered to use NAFTA as a sword against regulation, rather than a shield against discriminatory expropriation.<sup>83</sup> Take, for example, the following two cases. In 1994, R.J. Reynolds and other U.S. tobacco companies threatened to bring a Chapter 11 claim for “hundreds of millions of dollars” against the Canadian government if the latter adopted “plain packaging” legislation for cigarettes.<sup>84</sup> The applicability of the NAFTA disciplines to the issue was made moot by a decision by the Canadian Supreme Court, striking the regulation as violative of free expression,<sup>85</sup> but NAFTA’s utility as a lever in the policy debate is clearly illustrated. Again, in April 1997, Ethyl Corporation, a U.S. manufacturer of the gasoline additive MMT,<sup>86</sup> brought a \$200 million claim alleging that a Canadian ban on the importation of MMT violated NAFTA Articles 1102, 1106 and 1110, pertaining

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<sup>82</sup> See Ganguly, *supra* note 8, at 119-20 (noting questions legislature must ask before enacting regulation potentially impacting foreign investors); see also James J. Brown, *Entering 2000 with Fewer Sovereign Powers and Expanded Compensable Property Rights: Dilemmas for Local Government*, 29 STETSON L. REV. 733, 744-45 (indicating local governments need to be aware of NAFTA’s compensable takings standard). Typical of the Chapter 11 claims, the Statement of Claim in the S.D. Myers Case argues that “Article 1110 of the NAFTA does not prevent governmental regulatory actions. It merely requires governments to compensate investors for interference with their property rights as set out in the NAFTA.” S.D. Myers Statement of Claim, *supra* note 6, ¶ 50.

<sup>83</sup> In the words of one authoritative study:

[I]t is increasingly apparent that the private rights of foreign investors are being used not as a defensive protection against government abuse because an investor is a foreign-owned company, but as a strategic offensive threat to be wielded against government decision-makers rendering or considering decisions adverse to the interests of a company involved. The cases demonstrate the lobbying capacity attached to Chapter 11, a capacity never envisaged when the NAFTA negotiations took place.

Mann, *supra* note 8, at 405.

<sup>84</sup> Schneiderman, *supra* note 8, at 525.

<sup>85</sup> *RJR-MacDonald Inc. v. Canada* [1995] 127 D.L.R. (4th) 1 (Can.); see also Schneiderman, *supra* note 8, at 502, 523-35 (discussing debates regarding relevance of NAFTA to tobacco regulation).

<sup>86</sup> MMT, or methylcyclopentadienyl manganese tricarbonyl, is “a highly toxic organo-metallic compound used primarily to increase the octane levels of unleaded gasoline” which has been used in Canadian gasoline until 1997. See *Ethyl Corporation v. Canada*, Statement of Defense, (Nov. 27, 1997) ¶¶ 29, 31 at <http://www.appletonlaw.com/cases/edefense.pdf>. [hereinafter Ethyl Statement of Defense].

to National Treatment, Performance Requirements, and Expropriation, respectively.<sup>87</sup> Canada settled the claim before the NAFTA tribunal reached the merits, agreeing to rescind the Manganese-based Fuel Additive Act,<sup>88</sup> issue a public statement asserting that it had no evidence of harm caused by MMT, and pay Ethyl approximately \$13 million.<sup>89</sup>

A second concern among critics is that NAFTA confers “supernational treatment”—special protections not enjoyed by domestic firms—to foreign investors.<sup>90</sup> Under the most expansive interpretation of Article 1110’s protections, this would be true even in the case of the United States.<sup>91</sup> If NAFTA expropriation claims against the United States are successful, foreign competitors will be seen to have received an unfair advantage in the domestic market. U.S. firms may argue that they should receive equivalent levels of protection in the interest of equal protection and fair competition, providing powerful fuel for domestic lobbying efforts for increased property protection. Domestic policy on the takings issue may thus be tilted in favor of private property interests by means of the ratification of an international agreement never intended to have such an effect.<sup>92</sup>

Finally, the treaty locks in a pre-commitment to investor protections that are difficult to alter because of the barriers to amendment.<sup>93</sup> This “supra-constitutionalism” is problematic per

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<sup>87</sup> *Id.* at Preface to ¶ 1. The April 14, 1997 Notice of Arbitration is not publicly available.

<sup>88</sup> Wagner, *supra* note 7, at 495.

<sup>89</sup> *Id.*

<sup>90</sup> See Edward M. Graham, *Regulatory Takings, Supernational Treatment, and the Multilateral Agreement on Investment: Issues Raised by Nongovernmental Organizations*, 31 CORNELL INT’L L.J. 599, 610 (1998) (describing concept of “supernational treatment” in context of draft text of Multilateral Agreement on Investment).

<sup>91</sup> This is so not only because the substantive standard is more generous to investors, but also because Chapter 11 does not incorporate the well-known procedural hurdles of ripeness and exhaustion provided for in U.S. takings jurisprudence.

<sup>92</sup> For discussion of the U.S. domestic debate on property rights and takings, see John D. Echeverria, *The Politics of Property Rights*, 50 OKLA. L. R. 351 (1997).

<sup>93</sup> David Schneiderman has compared the NAFTA model of investor protections to the establishment of a quasi-constitutional regime. Schneiderman, *supra* note 8, at 514-15; see also David Schneiderman, *Investment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 762-63 (2000) (“[Transnational economic] rules are a form of precommitment strategy that bind

se, insofar as it limits democratic governance by means of international agreements negotiated at the margins of the democratic process.<sup>94</sup> Moreover, NAFTA does not require that these broadly-defined investor protections be balanced against competing social concerns, such as human rights, environmental protection, or public health.<sup>95</sup>

### III

#### REVIEWING THE ARTICLE 1110 DECISIONS

The activity surrounding the early Chapter 11 claims raised justifiable fears concerning the chapter's possible effects on environmental and social regulation. However, a thorough evaluation of the likely effects of Chapter 11—and Article 1110 in particular—requires further analysis of how expropriation claims have been decided. This Part begins this examination with an overview of the arbitral awards in the four Article 1110 claims decided on the merits in the course of the year 2000,<sup>96</sup> as well as the pleadings in *Methanex* and other pending claims.

#### A. *DESONA*

The first NAFTA claim to be decided on the merits was

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future generations of citizens to certain predetermined institutional forms through which politics is practiced.”)

<sup>94</sup> See Schneiderman, *supra* note 91, at 763-64 (arguing that strategy of precommitment to transnational economic rules is suspect).

<sup>95</sup> References to such social interests in Chapter 11 and NAFTA in general are nonspecific, making them unenforceable in arbitrations. Ganguly, *supra* note 8, at 130. Ganguly attributes the absence of specific environmental and public health safeguards in NAFTA and other international trade and investment instruments to the fact that such instruments are negotiated by specialists and are characterized by a “rather serious lack of interest in issues outside of pure investment-driven analysis . . .” *Id.* at 129-31. In this respect, NAFTA does not compare favorably with the European Union model in which private property protections are balanced against governmental interests in social benefits. Mann, *supra* note 8, at 409.

<sup>96</sup> A fifth case, brought by United States firm Waste Management, Inc. against Mexico for alleged violations of Articles 1105 and 1110, was decided against the claimant in June 2000 on procedural grounds. The tribunal determined that the claimant had failed to meet with the requirements of Article 1121(2)(b) that the claimant waive the right to initiate or continue alternative proceedings with respect to the claim at issue. See *Waste Management v. United Mexican States*, ICSID Case Num. ARB(AF)/98/2, Arbitral Award (June 2, 2000), 15 ICSID REV. – FOREIGN INV. L.J. 214, 239 (2000).

brought in March 1997 against the Mexican government by a group of three U.S. shareholders of Desechos Solidos de Naucalpan, S.A. de C.V. (DESONA).<sup>97</sup> Claimants alleged that the premature nullification of DESONA's fifteen-year concession contract to provide waste collection and disposal services to the city of Naucalpan constituted violations of NAFTA Articles 1110 and 1105, governing Expropriation and Minimum Standard of Treatment. Specifically, it was alleged that the nullification of the contract constituted "the direct expropriation of DESONA's contractual rights" and "the indirect expropriation of DESONA itself," and that this breach was "confiscatory."<sup>98</sup>

In November 1999, the tribunal decided in favor of the Mexican government, upholding Mexico's defense that the contract had come to an end on the grounds of invalidity and rescission. Significantly, for the purposes of NAFTA expropriation "jurisprudence," the tribunal noted that:

Labeling is . . . no substitute for analysis. The words "confiscatory," "destroy contractual rights as an asset," or "repudiation" may serve as a way to describe breaches which are to be treated as extraordinary, and therefore as acts of expropriation, but they certainly do not indicate on what basis the critical distinction between expropriation and an ordinary breach of contract is to be made.<sup>99</sup>

The contract in this case was made under Mexican law, and had been judged by Mexican courts to be invalid as a result of substantial "irregularities" and noncompliance in its performance. The NAFTA tribunal refused to exercise "international review of the national court decisions" in the absence of clear evidence of "denial of justice, or a pretence of form to achieve an internationally unlawful end."<sup>100</sup> The tribunal found no evidence of such a denial of justice in the case, given DESONA's apparent series of misrepresentations and failures to perform under the contract.<sup>101</sup>

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<sup>97</sup> ICSID Additional Facility Award, *Between Robert Azinian, Kenneth Davitian, & Ellen Baca, Claimants, and the United Mexican States, Respondent*, Nov. 1, 1999, 14 ICSID REV. – FOREIGN INV. L.J. 1, 1-9 (1999) [hereinafter *DESONA Award*].

<sup>98</sup> *Id.* ¶¶ 88-89, at 25.

<sup>99</sup> *Id.* ¶ 90, at 26.

<sup>100</sup> *Id.* ¶ 99, at 29.

<sup>101</sup> *Id.* ¶¶ 103-124, at 29-35.

### B. *Metalclad*

At the time of this writing, the *Metalclad* case had the distinction of being the only successful NAFTA expropriation claim decided on the merits. Metalclad Corporation, a U.S. firm, brought a claim under the ICSID Additional Facility against the government of Mexico in January 1997.<sup>102</sup> The claim alleged violations of Articles 1105 and 1110 in connection with Metalclad's development and operation of a hazardous waste landfill in the state of San Luis Potosí, Mexico.<sup>103</sup>

The tribunal found that Metalclad was effectively prevented from developing the landfill in question by Mexican state and municipal authorities. Despite having obtained federal and state permits in 1993, and having complied with enhanced environmental requirements imposed in 1994, the facility was prevented from operating following completion of construction in 1995. This obstruction was premised on the denial of a municipal building permit, as well as opposition by the state government. Following initiation of arbitration proceedings under NAFTA, the state government declared the landfill and surrounding area a "natural area" for the protection of a rare cactus.

The tribunal first upheld Metalclad's Article 1105 "minimum standards of treatment" claim. It held that even if a municipal construction permit were required, "as to hazardous waste evaluations and assessments, the federal authority's jurisdiction was controlling and the authority of the municipality only extended to appropriate construction requirements."<sup>104</sup> It was concluded that the denial of the municipal permit was made solely on the basis of environmental concerns and the opposition of the local population, rather than "any consideration of, or specific reference to" construction aspects or flaws of the physical facility."<sup>105</sup> The tribunal went on to hold that Metalclad was entitled to rely on assurances of compliance by the state and federal governments.

With respect to the Article 1110 claim, the tribunal concluded

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<sup>102</sup> Metalclad Award, *supra* note 7, ¶ 8, at 173.

<sup>103</sup> The facts of the case, as found by the tribunal, are complex and need not be recited at length here. For an in-depth recitation of the facts, see *id.* ¶¶ 28-69, at 179-189.

<sup>104</sup> *Id.* ¶ 86, at 192.

<sup>105</sup> *Id.* ¶ 93, at 193.

that

expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be-expected economic benefit of a property even if not necessarily to the obvious benefit of the host State.<sup>106</sup>

The municipality's denial of a construction permit without any basis relating to the physical construction or defect in the site, and its judicial and administrative actions to prevent operation of the site, together with the federal government's representations, "effectively and unlawfully prevented the Claimant's operation of the landfill"<sup>107</sup> and "amount[ed] to an indirect expropriation."<sup>108</sup> The Mexican government's actions underlying both the Article 1105 and Article 1110 claims were found to "involve the complete frustration of the operation of the landfill and negate the possibility of any meaningful return on Metalclad's investment."<sup>109</sup> Consequently, Metalclad was awarded approximately \$17 million in damages.

### *C. Pope & Talbot*

Pope & Talbot, a U.S.-based lumber products company, brought a NAFTA claim against the Canadian government in March 1999, alleging that Canada's allocation of softwood export quotas on violated NAFTA Articles 1102, 1105, 1106 and 1110, governing National Treatment, Minimum Standards of Treatment, Performance Requirements, and Expropriation, respectively.<sup>110</sup> The claim concerned Canada's administration of export quotas required by the Canada-U.S. Softwood Lumber Agreement.<sup>111</sup> In

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<sup>106</sup> *Id.* ¶ 103, at 195.

<sup>107</sup> *Id.* ¶ 106, at 195-96.

<sup>108</sup> *Id.* ¶ 107, at 196.

<sup>109</sup> *Id.* ¶ 113, at 197.

<sup>110</sup> The Claimant reserves the right to bring a claim under Article 1103 (Most Favored Nation), but did not articulate such a claim in its Statement of Claim. See Statement of Claim, Pope & Talbot, Inc. and Government of Canada, (Mar. 25, 1999), ¶¶ 10-11 [hereinafter Pope & Talbot Statement of Claim], at <http://www.appletonlaw.com/cases/STATEMENT%20OF%20CLAIM.pdf>. The Notice of Intent to Submit a Claim is not publicly available.

<sup>111</sup> *Id.* ¶¶ 14-21.

essence, Pope & Talbot argued that the distribution of quotas was made in a discriminatory manner, which caused a disproportionate constriction in Pope & Talbot's softwood exports to the U.S. relative to other producers. With specific regard to the Article 1110 claim, Pope & Talbot contended that the administration of the Export Control Regime "deprived [Pope & Talbot] of its ordinary ability to alienate its product to its traditional and natural market."<sup>112</sup> Moreover, "[e]ach time Canada reduced [Pope & Talbot's] allocation of fee-free quota, a further expropriation occurred."<sup>113</sup>

On June 27, 2000, the tribunal issued an interim decision allowing the Article 1102 and 1105 claims to go forward, and dismissing Claimant's Article 1106 and Article 1110 claims.<sup>114</sup> Significantly, the tribunal upheld Pope & Talbot's claim that its "access to the U.S. market is a property interest subject to protection under Article 1110."<sup>115</sup> Moreover, the *Pope & Talbot* tribunal also rejected Canada's contention that the regulatory character of its actions made it immune from liability. The award noted that "[r]egulations can indeed be exercised in a way that would constitute creeping expropriation . . . . Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation."<sup>116</sup>

However, the tribunal found that Canada's actions in relation

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<sup>112</sup> *Id.* ¶ 93.

<sup>113</sup> *Id.* ¶ 94.

<sup>114</sup> Interim Award, Pope & Talbot Inc. and The Government of Canada (June 26, 2000) available at <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> [hereinafter Pope & Talbot, June 26 Award]. On April 10, 2001, the tribunal issued its final award on the Article 1102 and Article 1105 claims. Virtually all of these claims were rejected, with the exception of a small subset of Article 1105 claims. Award on the Merits of Phase 2, Pope & Talbot, Inc. and The Government of Canada (Apr. 10, 2001), ¶¶ 194-195, available at [http://www.dfait-maeci.gc.ca/tna-nac/Award\\_Merits-e.pdf](http://www.dfait-maeci.gc.ca/tna-nac/Award_Merits-e.pdf) [hereinafter Pope & Talbot, Award on the Merits of Phase 2].

<sup>115</sup> Pope & Talbot, June 26 Award, *supra* note 114, ¶ 96.

<sup>116</sup> *Id.* ¶ 99. The citation is somewhat ironic, given that the comment in question specifically notes that "[a] state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory. . . and is not designed to cause the alien to abandon the property to the state or sell it at a distress price." RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §712 cmt. g (1986).

to Pope & Talbot did not constitute such a creeping expropriation. The test, according to the tribunal, is “whether . . . interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from the owner.”<sup>117</sup> Expropriation, creeping or otherwise, requires a “substantial deprivation” of the enjoyment of property rights; the reduction in Pope & Talbot’s profits, in the context of continuing control of its own operations, does not constitute such a substantial deprivation.<sup>118</sup>

In reaching this judgment, the tribunal decisively rejected the contention that the phrase “tantamount to expropriation” in Article 1110 constitutes a *lex specialis*—a law particular to the NAFTA—extending investor protection from expropriation beyond that which is traditionally enjoyed under customary international law. Pope & Talbot had argued that this phrase was analogous to the Iran-U.S. Claim’s Tribunal’s mandate to consider claims involving expropriation and “other measures affecting property rights.”<sup>119</sup> The tribunal disagreed, concluding that “tantamount” means “equivalent” and “[s]omething that is equivalent to something else cannot logically encompass more.”<sup>120</sup> In summary, “measures are covered only if they achieve the same results as expropriation.”<sup>121</sup>

Later, in its April 2001 Award on the Merits of Phase 2,<sup>122</sup> the *Pope & Talbot* tribunal found that Canada did not violate Article 1102,<sup>123</sup> but did violate Article 1105 with respect to a “verification review episode” in which Canada’s Softwood Lumber Division reviewed an apparent discrepancy between Pope & Talbot’s production and sales in 1994-1995.<sup>124</sup> In so doing, the tribunal construed both provisions expansively in favor of investor protection. With respect to Article 1102, the tribunal held that failure to provide national treatment need not be the result of de jure or intentional discrimination, but rather could be the result of

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<sup>117</sup> Pope & Talbot, June 26, 2000 Award, *supra* note 114, ¶ 102.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* ¶ 104.

<sup>120</sup> *Id.* The Tribunal notes that the words “equivalente” and “équivalent” are used in the equally authoritative Spanish and French texts of the treaty, respectively. *Id.* at n. 85.

<sup>121</sup> *Id.* at n. 87.

<sup>122</sup> Pope & Talbot, Award on the Merits of Phase 2, *supra* note 111.

<sup>123</sup> *Id.* ¶¶ 30-104, 194.

<sup>124</sup> *Id.* ¶¶ 105-85, 195. Damages had yet to be awarded at the time of this writing.

de facto discrimination, i.e., discriminatory effects.<sup>125</sup> The tribunal went on to find that treatment given to foreign investors would be compared “with that accorded domestic investments in the same business or economic sector,” and that “[d]ifferences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.”<sup>126</sup> With respect to Article 1105, the tribunal found that the provision’s fair and equitable treatment requirements were not coextensive with, but in addition to, the minimum standard of treatment in international law, and that the provision “require[s] that covered investors and investments receive the benefits of the fairness elements under the ordinary standards applied in the NAFTA countries.”<sup>127</sup>

#### D. S.D. Myers

In October 1998, S.D. Myers Inc., a U.S. firm engaged in the disposal of PCBs (polychlorinated biphenyls), brought a \$20 million NAFTA claim against the government of Canada. S.D. Myers had established a Canadian subsidiary with the intent to export PCBs to the U.S. for disposal. In 1995, the U.S. Environmental Protection Agency granted permission to S.D. Myers to import PCBs,<sup>128</sup> but Canada immediately imposed an export ban. S.D. Meyer’s claim alleged that the ban violated NAFTA Articles 1102, 1105, 1106 and 1110, governing National Treatment, Minimum Standards of Treatment, Performance Requirements, and Expropriation, respectively.<sup>129</sup>

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<sup>125</sup> *Id.* ¶ 70.

<sup>126</sup> *Id.* ¶ 78.

<sup>127</sup> *Id.* ¶¶ 111, 118. This holding ultimately provoked the NAFTA parties to adopt an interpretive statement providing, inter alia, that Article 1105 is based on the “customary international law minimum standard of treatment” and that “the concepts of ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition to or beyond that which is required by the customary international law minimum standard . . .” Notes of Interpretation of Certain Chapter 11 Provisions (NAFTA Free Trade Commission, July 31, 2001), *supra* note 79.

<sup>128</sup> This permission, granted first as an “enforcement discretion” and later through an “Import for Disposal Rule,” were overturned by the U.S. Court of Appeals for the Ninth Circuit in 1997 as violative of U.S. environmental statutes. *Sierra Club v. EPA*, 118 F.3d 1324 (9th Cir. 1997).

<sup>129</sup> See S.D. Myers Statement of Claim, *supra* note 6, ¶¶ 10, 35-55.

In a November 2000 final decision on the merits, the tribunal upheld the Article 1102 and 1105 claims,<sup>130</sup> but rejected the Article 1110 claim. In denying the expropriation claim, the tribunal took a similar, but somewhat narrower, view of the legal standard than that which was articulated in *Pope & Talbot*. Expropriation, under this view, connotes a “taking” of a person’s “property,” in the interest of transferring ownership of that property to the government or some third party.<sup>131</sup> The tribunal’s distinction between expropriation and regulation is worth quoting at length:

The general body of precedent usually does not treat regulatory action as amounting to expropriation. Regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the Tribunal does not rule out that possibility.

Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by the state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs.<sup>132</sup>

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<sup>130</sup> S.D. Myers, Inc. v. Government of Canada, Partial Award, Nov. 13, 2000, ¶¶ 306-09 [hereinafter S.D. Myers Nov. 13, 2000 Award], available at <http://www.appletonlaw.com/cases/Myers%20-%20Final%20Merits%20Award.pdf>. The burden would be on S.D. Myers to establish the causal link between the National Treatment and Minimum Standard violations and its claimed losses. *Id.* ¶ 316. A decision on damages had not yet been reached at the time of this writing, but the Tribunal indicated that the “fair market value” compensation standard required for expropriation would not necessarily be appropriate. *Id.* ¶ 306.

<sup>131</sup> *Id.* ¶ 280.

<sup>132</sup> *Id.* ¶¶ 281-82. In a Separate Opinion Dr. Bryan Schwartz, one on the Tribunal’s three Arbitrators, comments at length and with implicit sympathy on the concerns expressed by critics of the NAFTA model. S.D. Myers Inc. and The Government of Canada, Separate Opinion by Dr. Bryan Schwartz, Nov. 12, 2000, ¶¶ 202-05, available at <http://www.appletonlaw.com/cases/Myers%20%20Concurring%20Final%20Merits%20Award.pdf>. Dr. Schwartz goes on to note that while

[t]here may be some cases where a measure that is presented as a regulation must, in law and justice, be treated as a nationalization or expropriation for the purposes of Article 1110. That said, I can also state that in the vast run of cases, regulatory conduct by public authorities is not remotely the subject of legitimate complaints under Article 1110.

The tribunal went on to express its agreement with the Interim Award in *Pope & Talbot* that the phrase “tantamount to expropriation” refers to “so-called ‘creeping expropriation’, rather than to expand the internationally accepted scope of the term expropriation.”<sup>133</sup> In finding that this was not a case of expropriation, the *S.D. Meyers* tribunal attached importance to the fact that the regulation imposed was temporary and did not effect a transfer of property or benefit to the government or other parties.<sup>134</sup>

In upholding the Article 1102 claim, the *S.D. Meyers* tribunal took a position similar to that of the *Pope & Talbot* tribunal: While discriminatory intent is relevant, it is not necessary to establish a breach of Article 1102.<sup>135</sup> With regard to Article 1105, the *S.D. Myers* tribunal did not go so far as the *Pope & Talbot* tribunal. It found that the “fair and equitable treatment” requirement of the provision was coextensive with the minimum standards of treatment in international law.<sup>136</sup> However, the tribunal also appeared to look favorably on the notion that Article 1105 is a catchall equitable provision that not only includes, but also goes beyond, all of the remaining Chapter 11 disciplines.<sup>137</sup>

#### E. Pending Claims

At the time of this writing, decisions are pending in a number of other Article 1110 claims. The most significant of these was the \$970 million claim filed in June 2000 by Methanex Inc. against the

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*Id.* ¶ 207.

<sup>133</sup> See *S.D. Meyers*, Nov. 13, 2000 Award, *supra* note 127, ¶ 286.

<sup>134</sup> *Id.* ¶ 287. Dr. Schwartz’s opinion also gives weight to the combined significance of the temporary nature of the measures and the absence of a clear transfer of wealth to any other party. *Id.* ¶¶ 220-21. Moreover, he notes the relevance of other provisions of NAFTA as well as the environmental and labor “side agreements” expressing “a concern that governments remain reasonably free to take measures that are in the public interest.” *Id.* ¶ 214. Finally, he notes that investors are given such a wide variety of protections under Chapter 11 that it is unnecessary and improper to give Article 1110 an unduly expansive interpretation. *Id.* ¶¶ 215, 222.

<sup>135</sup> *Id.* ¶¶ 252-56. In this case, the tribunal found that there was, in fact, discriminatory intent: Canada’s ban on PCB exports was motivated by its concern “to ensure the economic strength of the Canadian industry, in part, because it wanted to maintain the ability to process PCBs within Canada in the future.” *Id.* ¶ 255. The tribunal considered the goal to be legitimate but not the means, particularly given the availability of nondiscriminatory alternatives. *Id.*

<sup>136</sup> *Id.* ¶ 263.

<sup>137</sup> See *id.* ¶¶ 265-66.

state of California.<sup>138</sup> Methanex, a Canadian manufacturer of methanol, alleges that California's recent phase-out of the methanol-containing gasoline additive MTBE constitutes an expropriation in contravention of Article 1110, as well as a violation of Articles 1102 and 1105.<sup>139</sup> Methanex argues that its "market share, market access, and goodwill" constitute cognizable property interests under NAFTA, and that these interests have been impermissibly expropriated through the California order.<sup>140</sup> The gravitas of Methanex's claim, however, is that the order was discriminatorily enacted in exchange for campaign contributions to

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<sup>138</sup> In addition to the Methanex claim, there are a number of pending Chapter 11 cases not involving an Article 1110 claim. Most noteworthy among these is the \$10.5 billion claim brought by U.S. firm Sun Belt Water, Inc. against Canada. Sun Belt, which had planned to engage in bulk export of water from British Columbia to the United States, alleges that British Columbia's ban on such export constituted a violation of NAFTA Articles 1102, 1103, 1104, and 1105. See *Sun Belt Water, Inc. v. Her Majesty the Queen in Right of Canada*, Notice of Intent to Submit a Claim, at 3 (Nov. 27, 1998), at <http://www.dfait-maeci.gc.ca/tna-nac/Sunbelt.pdf>. See also Iain Jack, *U.S. Firm Eager to Take Another Run at Water Exports*, NAT'L POST, Mar. 26, 2001, at C3 available at 2001 WL 16664588. For a discussion of the British Columbia legislation and the surrounding issues under NAFTA, see Jamie W. Boyd, Comment, *Canada's Position Regarding an Emerging International Fresh Water Market With Respect to the North American Free Trade Agreement*, 5 NAFTA: L. & BUS. REV. AM. 325, 344-46 (1999).

A second pending claim not involving Article 1110 is a \$160-million claim brought by United Parcel Services (UPS) against Canada, in which UPS alleges that Canada's postal service has engaged in abusive and monopolistic behavior in the courier and parcel services market in violation of NAFTA Articles 1102 and 1105. See Notice of Arbitration, United Parcel Services of America, Inc. (UPS) and Government of Canada (Apr. 19, 2000), at <http://www.dfait-maeci.gc.ca/tna-nac/ups-noa.pdf>.

Most recently, in July 2001, Canadian firm ADF Group Inc. brought a \$90-million claim against the United States. The claim arises from the U.S. Department of Transportation's "buy American" requirements that effectively prohibited ADF's U.S. subsidiary from selling steel manufactured in the U.S., but fabricated in Canada, to the state of Virginia. These requirements are alleged to violate NAFTA Articles 1102, 1105, and 1106. See Notice of Arbitration, ADF Group, Inc. and Government of the United States of America (July 19, 2000), at <http://www.naftalaw.org/ADF%20Group%20Inc.%20and%20US%20-%20Notice%20of%20Arbitration.pdf>.

<sup>139</sup> See Methanex Draft Amended Claim, *supra* note 1, at 67-69. Methanex also alleges violations of Articles 1102 (National Treatment) and 1105 (Fair and Equitable Treatment). *Id.* at 42-66. For the U.S. response to Methanex's original claim, see generally *Methanex Corporation v. United States*, Statement of Defense of Respondent United States of America (Aug. 10, 2000), at <http://www.methanex.com/investorcentre/MTBE.htm>. For further commentary on the case, see generally Ferguson, *supra* note 8.

<sup>140</sup> See Methanex Draft Amended Claim, *supra* note 1, at 69-70.

California Governor Gray Davis by Archer Daniels Midland, the primary manufacturer of the competing product ethanol, in violation of NAFTA Articles 1102 and 1105.<sup>141</sup>

Two other pending high-profile Article 1110 cases involve not environmental or social regulations, but rather NAFTA tribunal review of allegedly expropriatory decisions rendered by U.S. courts. In October 1998, Canadian firm Loewen Group, Inc., brought a claim for \$725 million against the United States for alleged violation of NAFTA Articles 1102, 1105, and 1110.<sup>142</sup> The claim arose out of a \$500 million jury verdict—including \$400 million in punitive damages—in a commercial suit against Loewen in Mississippi state court.<sup>143</sup> Loewen's NAFTA claim alleges that the excessive verdict, and the subsequent denial of appeal and coerced settlement, "were tantamount to an uncompensated expropriation in violation of Article 1110 of NAFTA."<sup>144</sup> In January 2001, the NAFTA tribunal decided that it had jurisdiction over the claim, but a decision on the merits is still pending.<sup>145</sup>

In September 1999, yet another Canadian firm, Mondev International, Ltd., filed a \$50 million claim against the United States for alleged violation of Articles 1102, 1105, and 1110.<sup>146</sup> The claim stems from the City of Boston's alleged breach of a contract providing Mondev's U.S. subsidiary with an option to purchase certain commercial real estate.<sup>147</sup> The subsidiary

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<sup>141</sup> See *id.* at 48-68. See also Jim Carlton, *Methanex Questions Davis-ADM Meeting in Gas-Additive Case*, WALL ST. J., Mar. 30, 2001, at B5.

<sup>142</sup> See Notice of Claim, Loewen Group, Inc. v. United States (Oct. 30, 1998), at <http://www.naftalaw.org/loewen.pdf> [hereinafter Loewen Notice]. For further discussion of the claim, see generally, Michael I. Krauss, *NAFTA Meets the American Torts Process: O'Keefe v. Loewen*, 9 GEO. MASON L. REV. 69 (2000). See also Mark Ballard, *Foreign Firms Get New Appeal Right: Panel Rules NAFTA Shield Covers Canadian, Mexican Gripes About U.S. Verdicts*, NAT'L L.J., Mar. 19, 2001, at A5.

<sup>143</sup> See Loewen Notice, *supra* note 142, ¶¶ 22-138.

<sup>144</sup> *Id.* ¶ 162.

<sup>145</sup> See Decision of the Arbitral Tribunal on Hearing of Respondent's Objection to Competence and Jurisdiction, *The Loewen Group, Inc. v. United States* (Jan. 5, 2001), <http://www.naftalaw.org/Loewen%20Award%20on%20Jurisdiction.pdf>.

<sup>146</sup> See Notice of Arbitration, *Mondev International, Ltd. v. United States* (Sept. 1, 1999), <http://www.naftalaw.org/mondev.pdf> [hereinafter Mondev Notice].

<sup>147</sup> See *id.* ¶¶ 33-65.

originally won a suit in Massachusetts state court for breach of contract, but the Supreme Judicial Court of Massachusetts overturned this verdict on appeal.<sup>148</sup> Mondev claims that this judicial decision effected an expropriation of its contractual “investment” in violation of Article 1110.<sup>149</sup>

Finally, U.S. citizens have brought two additional pending Article 1110 claims against Mexico. In April 1999, Marvin Feldman Karpa brought a \$50 million claim against Mexico, alleging, *inter alia*, that Mexico’s refusal to provide Karpa’s Mexican subsidiary with legally mandated tax rebates for cigarette exports violated Articles 1105 and 1110.<sup>150</sup> Most recently, in February 2001, Billy Joe Adams and other U.S. investors brought a \$75 million claim against Mexico alleging violations of Articles 1102, 1105, and 1110.<sup>151</sup> Claimants sought to recover the loss of investments in tourism-oriented improvements on lands held by the Mexican government. The value of these improvements was allegedly expropriated when the Mexican government, in compliance with an order handed down by the Mexican Supreme Court in 2000, returned these lands to the original landowners from whom it had expropriated the land in 1973.<sup>152</sup>

#### IV

#### ARTICLE 1110 JURISPRUDENCE: EMERGING PRINCIPLES & LINGERING DOUBTS

Despite the small number of claims decided on the merits, some emerging jurisprudential trends can be detected in the decisions; each of these, however, is accompanied by a host of unresolved ambiguities. This Part offers some conclusions regarding these emerging principles and lingering doubts, with the aim of opening debate regarding potential directions for

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<sup>148</sup> See *id.* ¶¶ 86-119; *Lafayette Place Assoc. v. Boston Redev. Auth. & City of Boston*, (Mass. Sup. Ct. Oct. 21, 1994), *rev’d.*, 694 N.E.2d 820 (Mass. 1998), *cert denied*, 525 S. Ct. 1177 (1999).

<sup>149</sup> Mondev Notice, *supra* note 146, ¶¶ 122-33.

<sup>150</sup> See Notice of Arbitration, *Marvin Roy Feldman Karpa v. United Mexican States* (Apr. 1999), at [http://www.cyberus.ca/~tweiler/karpa\\_01.pdf](http://www.cyberus.ca/~tweiler/karpa_01.pdf) [hereinafter *Karpa Notice*].

<sup>151</sup> Notice of Arbitration, *Adams v. United Mexican States* (Feb. 16, 2001), at <http://www.naftalaw.org/Adams%20et%20al%20and%20Mexico%20%20Notice%20of%20Arbitration.pdf> [hereinafter *Adams Notice*].

<sup>152</sup> See *id.* at 5-12, 17-19.

international standards regarding regulatory expropriations.

### A. *Applicable Law & Legal Method*

A few preliminary observations may be made with respect to the tribunals' approach to applicable law and legal method. First and foremost, none of the decisions endorses the view advanced by several of the claimants that the NAFTA "indirect expropriation" or "tantamount to expropriation" standards constitutes a *lex specialis* that expands investor rights beyond those provided by customary international law.<sup>153</sup> Whatever the ambiguity of the underlying customary international law standard, at the very least the tribunals appear to honor the intent of the NAFTA parties not to create "new" rights.<sup>154</sup>

Interestingly, though, the tribunals make virtually no reference to external authorities—judicial or scholarly—in support of their interpretation of the "old" rights supplied by customary international law.<sup>155</sup> A detailed analysis of the few sources cited would be superfluous here, but it should be noted that the support

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<sup>153</sup> See, e.g., *supra* notes 119-121 and accompanying text; *supra* note 133 and accompanying text.

<sup>154</sup> In a submission to the Tribunal in the *Metalclad* case, the United States government "rejected the suggestion that the term 'tantamount to expropriation' was intended to create a new category of expropriation not previously recognized in customary international law." *Metalclad Award*, *supra* note 7, ¶ 27, at 178-79. In fact, there appears to be trilateral agreement on this point, based on the positions taken by the Mexican and Canadian governments. See Joseph de Pencier, *Investment, Environment and Dispute Settlement: Arbitration Under NAFTA Chapter 11*, 23 HASTINGS INT'L & COMP. L. REV. 409, 415 (2000).

<sup>155</sup> The *DESONA* tribunal cited one scholarly authority in support of its determination that states are responsible for the acts of judicial authorities only in certain limited circumstances. See *DESONA Award*, *supra* note 97, at 28. The citation is to Eduardo Jiménez de Aréchaga, *International Law in the Past Third of a Century*, 159-1 RECUEIL DES COURS (General Course in Public International Law, The Hague, 1978). The *Metalclad* tribunal cited one case, *Biloune v. Ghana Investment Centre*, 95 I.L.R. 183 (1990), noting that "[a]lthough the decision . . . does not bind this Tribunal, it is a persuasive authority and the Tribunal is in agreement with its analysis and its conclusion." *Metalclad Award*, *supra* note 7, ¶ 108 at 29. The *Pope & Talbot* interim award cites only Comment (g) to §712 of the RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES, as well as the *Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens*. *Pope & Talbot*, June 26, 2000 Award, *supra* note 114, ¶¶ 99, 100, 102; see also *supra* note 60. The *Pope & Talbot* interim award is the only authority cited by the *S.D. Myers* tribunal. See *S.D. Myers*, Nov. 13, 2000 Award, *supra* note 130, ¶ 280.

they provide is shaky at best.<sup>156</sup> This pattern supports the critics' contention that existing international law principles and precedents governing regulatory expropriations are not sufficiently well defined to be predictable.<sup>157</sup> One gets the impression from the awards that the tribunals are making their decisions primarily by applying broad equitable principles to the particular facts at hand.

However, these equitable principles do not appear to embrace any notion that investor protections should be balanced against other concerns. Both critics and supporters of Chapter 11 have suggested that Article 1110 should be interpreted in light of environmental or other social considerations. Some argue that Article 1114 and NAAEC<sup>158</sup> provide an indication of the state parties' intent to avoid derogation of environmental standards, which should be taken into consideration in the interpretation of Article 1110.<sup>159</sup> Others suggest that a balancing test might be employed, weighing "the reasonableness of the regulatory objective, the proportionality of the regulatory means used to achieve that objective, and the extent of interference with property rights."<sup>160</sup>

The claims discussed in this Note suggest that these approaches are unlikely to provide significant deference to environmental concerns. Neither *DESONA* nor *Pope & Talbot* involved environmental or social regulations. In *Metalclad*, however, the tribunal found that the impropriety of the municipality's denial of the building permit on environmental grounds was not affected by Article 1114. The fact that the federal government—given exclusive environmental regulatory authority over hazardous waste facilities under Mexican law—had approved the project was sufficient to show that "Mexico was satisfied that this project was consistent with, and sensitive to, its environmental

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<sup>156</sup> *Biloune*, for example, concerned the forced expulsion of the investor from the country with the specific purpose of taking his property, a scenario not at all similar to that encountered in *Metalclad*. See *Biloune*, *supra* note 155, at 199-200, 209-10; SORNARAJAH, *supra* note 29, at 315.

<sup>157</sup> See discussion at *supra* Part II.A.

<sup>158</sup> See *supra* notes 57-58 and accompanying text.

<sup>159</sup> See Wagner, *supra* note 8, at 478-80; Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 250-51 (2000).

<sup>160</sup> Banks, *supra* note 8, at 506.

concerns.”<sup>161</sup> The *S.D. Myers* tribunal concluded that Chapter 11 should be interpreted in light of the following principles: “Parties have the right to establish high levels of environmental protection. They are not obliged to compromise their standards merely to satisfy the political or economic interests of others states; Parties should avoid creating distortions to trade; environmental protection and economic development can and should be mutually supportive.”<sup>162</sup> However, the tribunal goes on to state that a logical corollary of these principles is that states are obliged to adopt the least trade-restrictive measures possible.<sup>163</sup> This principle is not employed in relation to the Article 1110 claim in that case, but would tend to suggest that any “balancing” of regulatory against property interests would be heavily weighted towards the latter.

### B. Property & Substantiality

The definition of compensable property interests is the foundation of expropriation jurisprudence. Chapter 11 does not protect property per se, but rather broadly defined “investments,”<sup>164</sup> and the early Article 1110 decisions clearly demonstrate the significance of this choice in opening the way to a more expansive—and potentially problematic—definition of expropriation. Tribunals have found both “market access,” in the *Pope & Talbot* claim,<sup>165</sup> and “market share,” in the *S.D. Myers* claim, to constitute such interests.<sup>166</sup> The issue of how property is conceptualized has received comparatively little attention in international law,<sup>167</sup> but these tribunals’ expansive approach goes well beyond any reported international law precedent. This issue will likely be a key factor in the determination of the *Methanex*

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<sup>161</sup> Metalclad Award, *supra* note 7, ¶ 98, at 194. An interesting question is whether the tribunal would have ruled differently, if the federal, rather than the municipal, government had withdrawn the permits on the basis of environmental concerns, even in light of the investor’s reasonable, investment-backed expectations. See *infra* Part IV.C.

<sup>162</sup> *S.D. Myers*, Nov. 13, 2000 Award, *supra* note 130, ¶ 220.

<sup>163</sup> *Id.* ¶ 221.

<sup>164</sup> See *supra* note 14.

<sup>165</sup> See *supra* note 178 and accompanying text.

<sup>166</sup> See *S.D. Myers*, Nov. 13, 2000 Award, *supra* note 130, ¶ 232.

<sup>167</sup> See Dolzer, *supra* note 53, at 42 (“[C]ommentators have long been preoccupied with [compensation], while rather scant attention has been paid to [the concept of property and the identification of “expropriation”].”).

case and similar claims in which state regulation does not directly interfere with tangible property or business operations.

Consistently, the most significant factor in determining what constitutes expropriation in these cases has been the substantiality of the effect on the claimant. In *Metalclad*, the only case judged to have effected an expropriation, it was crucial that the tribunal found the claimant to have been completely deprived of “any meaningful return” on its investment.<sup>168</sup> The *Pope & Talbot* tribunal made clear that, despite its judgment that market access is a property right, a mere reduction in profits did not constitute an expropriation of this right.<sup>169</sup> As mentioned above, the *S.D. Myers* tribunal distinguished regulation from expropriation primarily on the basis of the degree of interference with property rights: “Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference.”<sup>170</sup>

The criterion of substantiality or diminution of value has a long pedigree in both international and U.S. domestic law,<sup>171</sup> but it is difficult to apply without addressing the well-known “denominator” problem in takings jurisprudence.<sup>172</sup> The finding of a complete versus partial deprivation of property rights depends upon how the underlying property interest, or “denominator,” is defined. This is a slippery issue in the NAFTA context because of the agreement’s broad definition of “investment.” The various interpretive devices used to address the denominator problem in U.S. jurisprudence, already problematic in relation to takings of

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<sup>168</sup> See *supra* note 109 and accompanying text.

<sup>169</sup> See *supra* note 118 and accompanying text.

<sup>170</sup> S.D. Myers, Nov. 13, 2000 Award, *supra* note 130, ¶ 282.

<sup>171</sup> In United States regulatory takings jurisprudence, the “economic impact” of a regulation is widely recognized to be the most significant factor in determining whether a taking has occurred. See ROBERT MELTZ, ET AL., *THE TAKINGS ISSUE: CONSTITUTIONAL LIMITS ON LAND-USE CONTROL AND ENVIRONMENTAL REGULATION* 132 (1999) (discussing diminution of value inquiry in regulatory takings).

<sup>172</sup> See, e.g., *id.*, *supra* note 171, at 144-54 (discussing denominator problem in regulatory takings jurisprudence); John E. Fee, Comment, *Unearthing the Denominator in Regulatory Taking Claims*, 61 CHI. L. REV. 1535 (1994) (same). This issue is sometimes also referred to as the problem of “conceptual severance.” See Margaret Jane Radin, *The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings*, 88 COLUM. L. REV. 1667, 1674-78 (1988) (“[C]onceptual severance’ consists of delineating a property interest consisting of just what the government action has removed from the owner, and then asserting that that particular whole thing has been permanently taken.”).

land,<sup>173</sup> are of little or no use in relation to such intangibles as “market access” and “market share.”

### C. *Vested Rights/Investment Backed Expectations*

Another property concept likely to play a significant role in Article 1110 jurisprudence is that of “vested rights” or “investment-backed expectations.”<sup>174</sup> This concept is implicit in the tribunal’s award in *Metalclad*, which found that the claimant was justified in relying on governmental assurances and proceeding with its investment plans in the absence of a municipal permit.<sup>175</sup> Had this reliance been found unreasonable, or had the claimant not yet made a significant investment on this basis, the claim presumably would not have succeeded. The issue of vested rights will likely be important in the pending *Adams* claim, as well, in which the claimants’ investment in improvements of the subject property was allegedly based upon reasonable expectation—based on constructive notice—that the property was properly held by the Mexican federal government and was not subject to return to prior landowners.<sup>176</sup>

The concept of vested rights raises difficult questions as to how reasonableness of reliance should be construed. One might argue that firms must always anticipate regulation, particularly in heavily regulated areas such as those at issue in most of the cases at issue: hazardous waste transport and disposal, toxic chemical products, tobacco products, large-scale water export, and timber harvesting. If tribunals do not strictly police the reasonableness of reliance, this may create an incentive to over-invest in areas likely to be regulated in order to reap the full benefit of compensation.

### D. *Character of Government Regulation*

In addition to eschewing any balancing of investor protections

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<sup>173</sup> See Fee, *supra* note 172, at 1538-49 (discussing U.S. courts’ approaches to denominator problem in relation to takings of land).

<sup>174</sup> Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978). For further discussion of vested rights, see Theodore C. Taub, *Vested Rights and Equitable Estoppel*, SF08 ALI-ABA 913 (2000).

<sup>175</sup> The reasonableness of the reliance was based on several factors including the “official” character of state and federal government reassurances, as well as the limited role played by municipal governments in the regulation of hazardous waste under Mexican law. *Metalclad Award*, *supra* note 7, ¶¶ 81-89, at 191-92.

<sup>176</sup> See *Adams Notice*, *supra* note 151, at 17-18.

against environmental or social interests, the tribunals uniformly reject an absolute exemption for “regulatory” or “police powers” activities from the category of expropriation.<sup>177</sup> This determination comports with theory, policy, and precedent. The literature on “constructive takings” and “creeping expropriation” has long recognized that it is possible for governments to expropriate through regulatory measures,<sup>178</sup> and this is confirmed by a number of international arbitral awards.<sup>179</sup> The viability of a distinction between regulatory and non-regulatory expropriations is questionable,<sup>180</sup> and it is well known that governments may seek to use environmental or other regulation as a means to disguise either expropriation or protectionism. In the *Ethyl*,<sup>181</sup> *Methanex*,<sup>182</sup> and *S.D. Myers*<sup>183</sup> cases, for example, it was alleged that the regulations in question were supported by a “Baptist-Bootlegger”<sup>184</sup> coalition of environmentalists and industry players

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<sup>177</sup> For a discussion of the police power exemption and its purported exceptions, see Gudofsky, *supra* note 159, at 287-98. The *S.D. Myers* tribunal, alone, attempts to draw some distinction between regulations and takings. However, this distinction does not concern the *nature* of the government activity, but rather the *degree* of interference with the enjoyment of property discussed above at *supra* note 170 and accompanying text. The tribunal goes on to acknowledge that there might be circumstances in which even regulations achieve an expropriation. See *S.D. Myers*, Nov. 13, 2000 Award, *supra* note 130, ¶ 282.

<sup>178</sup> See Weston, *supra* note 60, at 110; SORNARAJAH, *supra* note 29, at 282-94 (discussing types of state interventions other than physical that could amount to takings).

<sup>179</sup> See, e.g., *Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt*, 32 I.L.M. 933 (1993) (holding cancellation of two tourist development projects in interest of preserving architectural heritage of global significance was compensable); *Biloune*, 95 I.L.R. 183 (1990) (holding prohibition on completion and partial demolition of infrastructure project on basis of alleged improprieties in project management was compensable expropriation).

<sup>180</sup> See Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 330-31 (1982).

<sup>181</sup> See *Ethyl* Statement of Defense, *supra* note 86, ¶¶ 79-80; see also Soloway, *supra* note 8, at 58-75 (suggesting that MMT regulation at issue in *Ethyl* claim was supported by coalition of environmentalists, ethanol producers, and car manufacturers).

<sup>182</sup> See *supra* note 141 and accompanying text.

<sup>183</sup> See *S.D. Myers* Statement of Claim, *supra* note 6, ¶¶ 35-39.

<sup>184</sup> See Soloway, *supra* note 8, at 59. “A ‘Baptist-Bootlegger’ framework posits that industry regulation is a function of the demands of a coalition of two special interest groups.” *Id.* The term comes from the prohibition era during which both groups supported prohibition, but for different reasons. Baptists

likely to benefit from the regulations. To exempt such measures from scrutiny simply by virtue of their regulatory character would be inappropriate. Closely related to the rejection of the police powers exemption is the cases' apparent endorsement of the "effects test" and concomitant rejection of any "public purpose" defense for expropriation claims.<sup>185</sup>

## V

### REORIENTING REFORM: LESSONS LEARNED FROM THE EARLY AWARDS

Having identified some significant patterns in the Chapter 11 tribunals' early expropriation jurisprudence, we are now in a position to evaluate the criticisms leveled against the Chapter 11 model and the accompanying proposals for reform. This Part offers such an evaluation in the form of three interconnected

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supported prohibition in the belief that it served the public good, while Bootleggers profited from selling illegal alcohol at high prices. *Id.* Under this framework, the "first group has a public interest agenda . . . . The second group, often an industry, has a wealth maximization agenda . . . [that] is not explicitly stated but is clothed in a public interest justification." *Id.*

<sup>185</sup> The use of the effects test under Article 1110 is consistent with the general consensus of scholarship and precedent in this area. *See* Mann & Von Moltke, *supra* note 8, at 41-42 (citing numerous authorities for proposition that liability is not affected by the legitimacy *vel non* of state purposes).

Sornarajah argues that the public purpose defense in expropriation jurisprudence has long been a dead letter, as it is nearly always possible to argue some benign intent. *See* SORNARAJAH, *supra* note 29, at 317 ("[I]t is unlikely that it will constitute more than a subsidiary, throwaway argument for illegality."); Domke, *supra* note 63, at 590-91 (noting that public purpose test not helpful).

An interesting wrinkle on the intent/effects dichotomy arises with respect to the question of who receives the benefit, if any, of the government action in question. The *Pope & Talbot* tribunal distinguishes itself from the others in giving significance to the fact that the allegedly expropriated property interests are not transferred to the government or to any third party. This fact is said to be one factor suggesting that the measure is not an indirect expropriation, a conclusion that appears to be based on the Canadian law notion that takings are only compensable if they are "usings." *See* Wagner, *supra* note 8, at 510-14 (discussing Canadian regulatory takings standard). This concept has also been explored in scholarly work in the U.S. context. *See generally* Jed Rubenfeld, *Usings*, 102 YALE L.J. 1077 (1993). The most likely rationale for such a distinction is that the presence of a "using" is an indication of an illegitimate purpose. In any case, the remainder of the tribunals give no attention to the "usings" factor. Rather, the sole issue is the claimant's loss *vel non* of the use and enjoyment of the property.

“lessons learned” regarding how best to focus efforts at reform of Chapter 11, and to address the issue of expropriation protections within the FTAA and other future multilateral investment agreements.

*A. Lesson 1: Article 1110 Is Not the First Priority for Short-Term Reform*

The case law at present suggests that the Article 1110 legal standard is not as problematic for environmental regulation as Chapter 11’s critics had predicted. Only the *Metalclad* claim has been successful thus far, a case in which truly egregious government conduct resulted in the complete loss of the claimant’s investment.<sup>186</sup> More importantly, two strands within the tribunals’ emerging jurisprudence significantly limit the scope of viable claims under Article 1110. First, the tribunals’ uniform rejection of the *lex specialis* argument prevents claimants from arguing for a definition of Article 1110 expropriation transcending traditional customary international law constraints. Second, and relatedly, the tribunals consistently have interpreted the customary international law definition of expropriation to require substantial or total deprivation of economic use of the investment or property in question. Regulations that merely affect some property interest or decrease the profitability of business simply do not fall within Article 1110’s purview. This is not to suggest that Article 1110 is altogether unproblematic, a point to which we will return shortly. But it is clear that the tribunals have not been nearly so biased in favor of investors’ rights as was initially feared, and that it is, in fact, rather difficult to make out a successful Article 1110 claim.

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<sup>186</sup> To the extent the facts are as the tribunal found them to be (a big assumption), this claim appears within the purview of traditional international law protections against expropriation; procedural issues apart (another big assumption) such a scenario might well constitute a compensable taking under the Fifth Amendment of the U.S. Constitution. Under these assumptions, the government actions at issue would probably constitute a compensable taking under *Lucas v. South Carolina Coastal Council*, as they appear to constitute a complete deprivation of economic use of the property. 505 U.S. 1003 (1992). Even if they did not meet this standard, they would very likely satisfy the multifaceted *Penn Central* test, given the tribunal’s finding of a major economic impact on what were considered to be legitimate investment-backed assumptions. See *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124-25 (1978).

The Article 1102 and 1105 claims by comparison, have had greater overall success and merit much greater attention than they have yet received in the literature.<sup>187</sup> While *S.D. Myers* represents the only successful Article 1102 claim on the merits, Article 1105 claims have succeeded in *S.D. Myers*, *Pope & Talbot*, and *Metalclad*. Articles 1102 and 1105 focus on issues of discrimination and due process that are, perhaps, even less well defined in international law than is expropriation. As Mann and Von Moltke point out, “the only area where there are precedents available is from international trade law, but this raises fundamental questions of their applicability in the very different context of investments.”<sup>188</sup> Damages claimed under these standards need not relate to predefined compensable property interests, but may proceed from virtually *any* economic injury to the claimant. These damages need not reach any threshold level of substantiality in order to be cognizable, as in the case of Article 1110. Instead, the provisions function as a general equitable redress of alleged wrongs against investors. In addition, any claim that can be brought under Article 1110 can be reformulated as an Article 1102 or Article 1105 claim by shifting the emphasis from expropriation, *per se*, to damages resulting from discriminatory or unfair treatment.

Given the foregoing, Articles 1102 and 1105 may present a significantly greater threat to governmental regulation than does Article 1110, and should be made the first priority for future reform efforts. Further reflection on the appropriate approach to such reform is beyond the scope of this Note, but it seems clear that to the extent that reform initiatives focus exclusively on Article 1110, they are unlikely to stem the growing tide of complaints based on these other provisions.<sup>189</sup> This conclusion is borne, in part, by the fact that the first interpretive statement adopted by the NAFTA parties focuses on limiting the Article 1105 “minimum treatment” standard to that level of protection

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<sup>187</sup> Among the commentators surveyed, only Mann & Von Moltke and Gantz give significant attention to these provisions. See Mann & Von Moltke, *supra* note 8, at 25-34; Gantz, *supra* note 8, at 10658-62.

<sup>188</sup> *Id.* at 6.

<sup>189</sup> Interestingly, the *Methanex* claim appears to focus significantly greater energy on the Article 1102 and 1105 claims than on the Article 1110 claim. See *Methanex Draft Amended Claim*, *supra* note 1, at 38-69. This may simply reflect the factual nature of the case, but may also be the result of the comparatively greater success of the Article 1102 and 1105 claims in prior decisions.

provided by customary international law.<sup>190</sup>

*B. Lesson 2: The Limited Utility of Isolated Interpretive Statements*

To the extent that Article 1110 has not, thus far, proved to be as expansive or dangerous as was feared, one might argue that the model should be permitted to function to allow “common law” development of the legal standard.<sup>191</sup> However, while this Note argues that Article 1110 should not be the number one priority for reform, it remains worthy of attention. The number of claims decided is quite small, and the tribunals have shown themselves capable of notable departures from traditional principles of international law.<sup>192</sup> Significant questions remain regarding the provision’s potential scope, most notably with respect to the concept of vested rights and the definition of compensable property interests.<sup>193</sup> The resulting unpredictability is problematic: Where governments are unsure of the governing standard, regulatory measures within the “penumbra” of Article 1110 may be chilled, and firms may continue to use the threat of indirect expropriation claims as a “sword” in policy debates and legislative lobbying.

Ultimately, the best way to address these concerns is through institutional reform rather than modification of the substantive legal standard of expropriation. However, the NAFTA parties are highly unlikely to pursue such ambitious changes to the Chapter 11 ISDM as a whole, at least in the foreseeable future. The adoption

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<sup>190</sup> See *supra* note 127.

<sup>191</sup> For one articulation of this position, see Charles N. Brower & Lee A. Steven, *Who Then Should Judge?: Developing International Rule of Law Under NAFTA Chapter 11*, 2 CHI. J. INT’L L. 193, 201 (2001) (“[A]s more and more cases are decided, the content of NAFTA’s substantive rules will be expounded, the Parties’ treaty obligations clarified, and important principles of international law refined, thus helping sustain and develop the rule-based investment regime that the NAFTA Parties are in the process of creating.”).

Loritz similarly concludes that reform of the legal standard is unnecessary. He advocates vigorous litigation of the Chapter 11 claims, arguing that the existing model favors governmental interests. See Loritz, *supra* note 8, at 549-51. Loritz mistakenly predicted that Metalclad would lose its claim against the Mexican government if it were decided on the merits. *Id.* at 550.

<sup>192</sup> For example, the *Pope & Talbot* tribunal’s unusual and expansive treatment of the Article 1105 “Fair and Equitable Treatment” provision resulted in an interpretive statement by the NAFTA parties effectively reversing its legal conclusion. See *supra* note 127 and accompanying text.

<sup>193</sup> See *supra* notes 164-167 and accompanying text; *supra* notes 174-176 and accompanying text.

by the NAFTA parties of a substantive interpretive statement,<sup>194</sup> defining limits upon the scope of Article 1110, presents a much more viable approach to reducing uncertainty and protecting legitimate regulatory prerogatives. Both Chapter 11's critics<sup>195</sup> and at least two of the three state parties<sup>196</sup> have recommended the adoption of such a statement. This section evaluates several proposed statements, highlighting the difficulties raised by each, and offering some guidance to would-be drafters.

### 1. *Applying Host-State Law*

One option, originally supported by Canada,<sup>197</sup> would be the issuance of an interpretive statement calling for the application of the host-state's legal standard of expropriation to Article 1110 claims. Underlying this approach is the notion that the primary rationale for the Chapter 11 model is procedural rather than substantive; e.g., U.S. investors do not believe that they will receive adequate protection in the Mexican court system.<sup>198</sup> In this light, it is not surprising that no direct ISDM was provided under the Canada-U.S. Free Trade Agreement.<sup>199</sup> Although Canadian

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<sup>194</sup> NAFTA's Article 1131 provides that arbitral tribunals will be bound by interpretations of Chapter 11 adopted by the NAFTA Commission, composed of the three state parties. NAFTA, *supra* note 2, art. 1131(2). It should be noted that there are limits as to how far an interpretive statement can go before it will be determined an amendment of the treaty, which would require a much more demanding process of state party approval.

The NAFTA Free Trade Commission has only issued one substantive interpretive statement to date, focusing on Article 1105. *See supra* note 79.

<sup>195</sup> *See, e.g.,* Mann & Von Moltke, *supra* note 8, at 8-10, 47-49, 71-73; Ferguson, *supra* note 8, at 517-18.

<sup>196</sup> Canada has long been a strong advocate of the adoption of an interpretive statement for Article 1110. Mann *supra* note 8, at 406; Wagner, *supra* note 8, at 467-68. The United States' stance on this approach has been divided, with some agencies favoring an interpretive statement and others opposing. Mann & Von Moltke, *supra* note 8, at 10. Mexico balked at the prospect of disturbing the existing mechanism, Mann, *supra* note 8, at 406; Mann & Von Moltke, *supra* note 8, at 10, presumably based on a desire not to upset the Chapter 11 mechanism, which is considered important in promoting investor confidence and encouraging foreign direct investment. The success of Metalclad's claim against Mexico and the growing number of claims against the United States, however, may generate increased consensus on the need for reform of the Article 1110 standard.

<sup>197</sup> Wagner, *supra* note 7, at 468.

<sup>198</sup> *See* Mann & Von Moltke, *supra* note 8, at 12; Soloway, *supra* note 8, at 88.

<sup>199</sup> *See supra* note 38 and accompanying text.

law does not provide a level of *substantive* protection against expropriation significantly greater than that provided by Mexican law,<sup>200</sup> U.S. investors do not have comparable apprehensions due to Canada's relatively similar court system.

Despite the theoretical arguments to be made for the application of the host-state's law of expropriation, at least in regulatory cases,<sup>201</sup> this proposal is neither politically viable nor likely to resolve existing ambiguities. First, the United States is highly unlikely to agree to a substantive standard so disadvantageous to U.S. investors, given that U.S. protections against expropriation are significantly greater than those of either Canada or Mexico. Moreover, because of the ad hoc, fact-based nature of U.S. takings jurisprudence, and the relatively constrained interpretation the tribunals have given to Article 1110, arbitral tribunals might well apply the U.S. standard more expansively than the international standard.

## 2. Reinforcing Customary International Law Limits

Given the experience under NAFTA, the proposed inclusion of Article 1110's language in the MAI draft negotiation text generated significant concern. In an attempt to quell this concern, the chairman of the MAI negotiations offered the following interpretive note:

The reference to expropriation or nationalization and "measures tantamount to expropriation or nationalization" reflect the fact that *international law requires compensation for an expropriatory taking without regard to the label applied to it, even if title to the property is not taken. It does not establish a new requirement that Parties pay compensation for losses which an investor or investment may incur through regulation, revenue raising and other normal activity in the public interest undertaken by governments.*<sup>202</sup>

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<sup>200</sup> See Wagner, *supra* note 8, at 510-17 (discussing regulatory takings under Canadian and Mexican law).

<sup>201</sup> Such arguments might focus on the notion that each state chooses its own preferred balance of regulatory powers and investor protections. Firms will, presumably, make choices about where to invest on the basis of the mix provided by each state, and thus states adopting too low a level of investor protection will be unable to attract FDI. Consequently, there will be market pressures for states to move toward some acceptable middle ground, consistent with citizen preferences expressed through the democratic process.

<sup>202</sup> MAI Negotiating Text, *supra* note 42, at Annex 2 (emphasis added).

This statement serves simply to clarify that the expropriation standard is not meant to provide a *lex specialis*. However, the Chapter 11 tribunals already unanimously support such an interpretation.<sup>203</sup> Moreover, “[w]hile the MAI draft text may not have established a ‘new’ requirement for compensation, this statement does not impact the interpretation of any already existing requirement under international law, or how to distinguish between compensable and non-compensable regulation.”<sup>204</sup>

### 3. Reinforcing the Public Purpose/Police Powers Exemption

As was noted above, the Chapter 11 tribunals have thus far rejected government arguments that environmental or social regulations should be exempted from Article 1110’s purview on the grounds that they represent a legitimate exercise of the state’s regulatory “police power” based on a public purpose.<sup>205</sup> In an apparent attempt to counter this trend, Mann and Von Moltke offer the following proposed interpretive statement:

For greater certainty, and without prejudice to any other interpretational issues, *Article 1110(1)*, as a matter of definition does not include within any of the terms set out in that Article, including “directly or indirectly nationalize or expropriate,” and “measure tantamount to nationalization or expropriation,” *non-discriminatory measures taken for a public purpose consistent with a legitimate objective as defined in Chapter 9 of NAFTA, and in accordance with due process of law and Article 1105 of NAFTA*. This interpretation does not create any other implications or applications to the interpretation of Article 1110 beyond its express words.<sup>206</sup>

The primary effect of this standard seems to be to change the inquiry from an examination of expropriatory effect of governmental measures to an exclusive focus on governmental purpose and nondiscrimination.<sup>207</sup> In so doing, the standard may be said to try to breathe life into the “public purpose” prong of traditional expropriation jurisprudence, using the definition of

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<sup>203</sup> See *supra* note 153-154 and accompanying text.

<sup>204</sup> Mann & Von Moltke, *supra* note 8, at 44.

<sup>205</sup> See *supra* notes 177-185 and accompanying text.

<sup>206</sup> *Id.* at 72-73 (emphasis added).

<sup>207</sup> See discussion of intent versus effects, *supra* note 185 and accompanying text.

*bona fides* provided in NAFTA's Chapter 9.<sup>208</sup>

This approach raises at least two significant problems. First, this standard seems to provide considerably less protection than traditional international law, even for direct expropriations. Under this standard, a government could, for example, condemn an investor's property for inclusion in a conservation area without being required to pay compensation, so long as it was done in a nondiscriminatory manner and in accordance with due process. While this may be in keeping with Canadian jurisprudence in some respects, it does not accord with international law and is unlikely to be acceptable to the United States. In addition, the standard appears merely to shift the burden of the expropriation inquiry onto the issues of nondiscrimination and due process.<sup>209</sup> Claimants have already shown that virtually any regulatory expropriation claim can be cast as a discriminatory treatment claim, and ostensibly legitimate regulatory purposes are often commingled with or mask protectionist or discriminatory purposes.<sup>210</sup> Where discrimination could be shown, Article 1110 would apply, and the tribunal would still be faced with determining what constitutes expropriation. But the Mann and Von Moltke interpretive statement does not offer any insight into the answer to that question.

#### 4. *Substantiality & Property*

Perhaps the most promising alternative would be to base the Article 1110 standard on the substantiality of the expropriation. Under this approach, Article 1110 would be interpreted to apply only to those governmental measures that have the effect of eliminating all or substantially all of the economic value of an investment,<sup>211</sup> where the investor expected (subjectively) and

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<sup>208</sup> NAFTA, *supra* note 2, art. 904(4).

<sup>209</sup> In fairness, Mann and Von Moltke also propose reforms to the Article 1102 and Article 1105 standards, but it is not clear that these proposals will necessarily have any great effect on a nondiscrimination inquiry. *See* Mann & Von Moltke, *supra* note 8, at 72 (proposing that regulations with a prima facie environmental purpose challenged under Articles 1102, 1103, 1106 and 1110 be considered in light of several mitigating factors).

<sup>210</sup> *See supra* notes 182-184 and accompanying text.

<sup>211</sup> Readers familiar with U.S. takings jurisprudence will recognize the connection between this approach and the Supreme Court's holding in *Lucas*, 505 U.S. 1003 (1992) (holding that complete elimination of economic value of property is per se taking).

could reasonably have expected (objectively) to be free from such regulation. This would tend to reinforce what the tribunals are already doing, that is, interpreting “indirect expropriation” and “tantamount to expropriation” to refer to actions with the same effect as direct expropriation or nationalization. It would, moreover, encourage the tribunals to police the reasonableness of the investor’s expectations. Clearly, this approach threatens to run afoul of Chapter 11’s broad definition of compensable property interests. As has already been discussed, it is quite difficult to define the proper “denominator” for the expropriation inquiry.<sup>212</sup> However, at the very least, it should be possible to define “investment,” *for purposes of Article 1110*, to exclude certain intangibles—such as “market access” and “market share”—that some of the NAFTA tribunals have recognized as compensable interests.

*C. Lesson 3: Institutional Alternatives to the ISDM Should Be the First Priority for Future Agreements*

Despite the potential merits of a well-designed interpretive statement to Article 1110, the foregoing discussion gives some idea of how challenging it is to define, a priori, all the elements of relevance to an expropriation inquiry. Many of the lingering interpretive doubts are nearly impossible to resolve in any categorical fashion, and even if such resolution were possible in theory, it would be difficult to achieve consensus among NAFTA’s state parties.<sup>213</sup> A careful reading of the tribunals’ decisions suggests that they represent fact-based equitable judgments in which the legal standard is, to some extent, both malleable and peripheral. This is partly because international law provides scant guidance as to the appropriate standard in regulatory expropriation claims and partly because, even where, as in the United States, there is a relatively well-developed body of jurisprudence on

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<sup>212</sup> See *supra* note 169-170 and accompanying text.

<sup>213</sup> In fact, this may be part of the reason for the provisions’ vagueness in the first place. In analyzing the expropriations of various bilateral investment treaties, Dolzer comments that “[p]resumably, the real reason for the widespread preference of short formulas has in fact been their simplicity and open-endedness which has avoided long and complicated discussions of a technical nature with broad potential implications for the economic liberties of the host country and the desire for protection of the investor as presented by this state.” Dolzer, *supra* note 53, at 55-56. For one example of an interpretive statement adopted by the NAFTA parties, see *supra* note 192.

regulatory takings, the complex nature of the claims seems to reduce judges to “essentially. . . *ad hoc* factual inquir[ies].”<sup>214</sup>

Under such circumstances, procedure and institutions are at least as important as substantive law. Even in the absence of clear substantive legal standards, transparent and consistent procedures can help to improve the quality and legitimacy of the decisions rendered by arbitral tribunals. More importantly, where claims implicate important public policy issues and are governed by ambiguous legal standards, adjudicative institutions and processes more directly responsive to national governments are more likely than *ad hoc* panels of private individuals to strike a workable and appropriate balance between investor protection and regulation. This is because governments, by virtue of their institutional role and accountability to national electorates, have an incentive to balance domestic regulatory prerogatives with their interest in fair treatment abroad for their investors.

With regard to procedure, there have been numerous proposals for reform aimed at improving transparency and public access to information in connection with the NAFTA ISDM.<sup>215</sup> The NAFTA states have taken one small step in this direction through the adoption of the July 31, 2001 interpretive statement regarding the confidentiality of submissions to NAFTA arbitral tribunals.<sup>216</sup> The *Methanex* tribunal’s agreement to accept amicus briefs from certain interested parties represents another procedural advance.<sup>217</sup> Such steps may help raise public consciousness and the political saliency of the Chapter 11 claims, but it is not clear that they will significantly influence the way in which the tribunals decide the merits of the claims before them. Moreover, they do not begin to address the deeper procedural issues such as relaxed evidentiary standards or the lack of appellate review.

Reform of the overall institutional model of the ISDM, while more important than procedural modifications, is considerably less likely to occur because it would dramatically upset the status quo. Nonetheless, drafters of the FTAA and other future multilateral trade and investment agreements should give careful consideration to models of dispute settlement providing greater institutional

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<sup>214</sup> Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

<sup>215</sup> See Mann & Von Moltke, *supra* note 8, at 51-58.

<sup>216</sup> See *supra* note 79.

<sup>217</sup> See *supra* note 81.

accountability. Among the more moderate of the alternatives is a “gatekeeper” model, in which government officials from the two relevant state parties would be given first opportunity to consider expropriation claims.<sup>218</sup> If both state-party representatives determine that a given claim is *not* expropriation, then the party is prevented from bringing the claim; if the state parties cannot agree, then the claim may go forward.<sup>219</sup> A second, and somewhat more radical alternative is to require only certain classes of claims, such as those raising serious public policy issues to be decided by government-to-government dispute resolution.<sup>220</sup> The most extreme option is, of course, to abandon the ISDM altogether in favor of a return to a state-state dispute mechanism, such as that in the Canada-U.S. Free Trade Agreement.<sup>221</sup>

Evaluation of these competing models turns, in large part, on the relative weight given to the competing values of investor security and state regulatory authority. Clearly, the investor-state mechanism under NAFTA strongly favors investor security and thus tends to encourage foreign direct investment. Each of the three reform proposals represents a successively lower level of investor security in the interest of greater public ability to regulate. What is unclear, however, is the sensitivity of foreign direct investment to marginal differences between the various mechanisms. If, as some reports have suggested, investor protections are not a primary determinant of levels of foreign direct investment,<sup>222</sup> there may be reason to opt for the more

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<sup>218</sup> NAFTA utilizes this mechanism in relation to taxation measures. See Mann & von Moltke, *supra* note 8, at 58. As Mann and von Moltke point out, “[a] somewhat similar gatekeeper process applies when a party relies on an exception to Chapter 11 [under treaty reservations] in its defense. Here, the Free Trade Commission can be asked by the investor or the disputing party to rule on whether the exception applies to their case or not.” *Id.*; NAFTA, *supra* note 2, art. 1132. An example of the functioning of this process is presented in the *Karpa* case, in which the claimant was not able to bring a Chapter 11 claim relating to taxation until tax officials from both the United States and Mexico agreed that the claim could proceed. See *Karpa Notice*, *supra* note 150, at 4.

<sup>219</sup> See Mann & Von Moltke, *supra* note 8, at 58.

<sup>220</sup> See *id.*

<sup>221</sup> See *supra* notes 37-38 and accompanying text. Alternatively, it would be conceivable to go further than NAFTA’s drafters dreamed by replacing the ISDM’s tripartite party-appointed tribunals with a standing dispute settlement body analogous to that of the World Trade Organization. This would provide greater “judicial” independence and stability, but would considerably lessen the political accountability for which this Note argues.

<sup>222</sup> See Schneiderman, *supra* note 93, at 764 (citing UN Commission on Trade

radical approach of returning to a state-state mechanism. However, Mexico's reticence to tinker with Chapter 11 suggests that there is at least some basis for the conclusion that investor confidence and levels of FDI are sensitive to marginal changes in the level of investor protection. Mann and Von Moltke's advocacy of the more moderate course—either the restriction of a certain class of disputes from the ISDM or the implementation of the gatekeeper model—may represent the best compromise.<sup>223</sup> A more decisive conclusion than this is beyond the scope of this Note, but the emerging jurisprudence of the Chapter 11 tribunals clearly supports the need for a radical reappraisal of the ISDM, both in the context of NAFTA and beyond.

#### CONCLUSION

This preliminary review of the NAFTA tribunals' early regulatory expropriations jurisprudence suggests that Chapter 11's critics ought to refocus their efforts. To date, regulatory expropriations claims simply have not proved to be as subversive of environmental and social regulation as was feared, and Articles 1102 and 1105 may present much more cause for concern and merit greater attention from would-be reformers. This is not to say that Article 1110 is unproblematic, and clearly, there is value in the project of clarifying the provision by means of a well-crafted interpretive statement. However, the prospects for constraining the Article 1110 expropriation standard by means of an isolated statement are not particularly bright, given the standard's resistance to a precise definition that is politically acceptable and practically viable. To achieve success, interpretive drafters must look much more comprehensively at the relationship between the expropriation language and the underlying definition of compensable property interests, as well as the relationship between Article 1110 and the other disciplines. Looking toward the longer term, Chapter 11's critics might do better to refocus their efforts on institutional reform of the ISDM. If we are to give adjudicative institutions the power to enforce international obligations with potentially major effects on public policy, it is critical that those institutions be appropriately accountable to national governments

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and Development reports indicating that "factors such as market size and growth, exchange rates and country risks are more important determinants of FDI.").

<sup>223</sup> See Mann & Von Moltke, *supra* note 8, at 58.

and the democratic process. The NAFTA ISDM is not equal to the task that it has inherited, and its reform is at least as high a priority as that of Chapter 11's substantive legal standards.

Even as efforts to reform NAFTA Article 1110 continue, the FTAA and other multilateral and bilateral investment agreements are under consideration. At the very least, the legal and institutional issues raised by the early Chapter 11 jurisprudence demand a radical reconsideration of the underlying model before it is imported wholesale into these other agreements. At stake is nothing less than the integrity of the democratic process and states' ability to regulate effectively for the preservation of public health and the natural environment.